No. 76-1058

Supreme Court, U. S.
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In the

Supreme Court of the United States

OCTOBER TERM, 1976

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

Petitioner Central Illinois Public Service Company respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit entered in the above-captioned case on August 17, 1976.

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (Appendix A, *infra*, pp. 1a-4a) are reported at 405 F.Supp. 748 (S.D.Ill. 1975). The opinion of the court of appeals (Appendix B, *infra*, pp. 5a-12a) is reported at 540 F.2d 300.

JURISDICTION

The judgment of the court of appeals (Appendix C, *infra*, p. 13a) was entered on August 17, 1976. A timely petition for rehearing was denied on November 4, 1976 (Appendix D, *infra*, p. 14a). The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Sections 3401 and 3402 of the Internal Revenue Code of 1954 require an employer to withhold federal income taxes only on a payment of "wages". "Wages" are defined in the statute to mean "remuneration . . . for services performed".

The questions presented are: (i) whether virtually all payments deemed to arise out of, or be attributable to, the employment relationship, such as petitioner's payments to reimburse noon meal expenses of its employees when they were traveling on petitioner's business, constitute "wages" for withholding tax purposes, as the court of appeals held; and (ii) whether withholding tax obligations may be retroactively imposed on an employer as a matter of law, as the decision below in effect held, as to payments which subsequently may be deemed to be "wages".

STATUTES AND REGULATIONS INVOLVED

The relevant portions of the Internal Revenue Code (26 U.S.C. 3401(a) and 3402(a)) and Treasury Regulations (Section 31.3401(a)-1) appear in pertinent part in Appendix E to this Petition (pp. 15a-16a, *infra*).

STATEMENT OF CASE

Petitioner is a public utility which, in the year 1963, reimbursed its employees, in accordance with its established policy, for legitimate travel expenses incurred in required trips for the Company's business. These payments included reimbursements for transportation, meals and lodging. Petitioner treated all of these payments as not being wages and did not withhold federal income taxes from them (Appendix A, *infra*, pp. 2a-3a).

The government contended that petitioner should have withheld on the portion of these reimbursements which was for noon meal expenses incurred on those trips which did not involve an overnight stay and assessed additional withholding taxes against petitioner. The amount of the additional withholding taxes and interest assessed for the four taxable quarters in 1963 amounted to $25,188.50 of taxes and interest of $11,427.22 (Appendix A, *infra*, p. 3a). Petitioner paid this amount and brought suit for refund.

The district court upheld petitioner's claim for refund (Appendix A, *infra*, pp. 1a-4a); the court of appeals reversed (Appendix B, *infra*, pp. 5a-12a).

REASONS FOR GRANTING THE WRIT

1. The decision below directly conflicts with *Royster Company* v. *United States*, 479 F.2d 387 (4th Cir. 1973). The court in *Royster* held, on facts "not meaningfully distinguishable" as specifically acknowledged by the court below,[1] that payments by an employer to salesmen to reimburse them for noon meal expenses incurred on non-overnight business trips for the employer did not constitute wages for withholding purposes. Contrary to the Fourth Circuit, the court below embraced the proposition that virtually all payments attributable to the employment relationship constitute remuneration for services performed and, therefore, are "wages" for withholding tax purposes. Indeed, the Seventh Circuit took the view that any other definition would be too narrow.

Resolution of the conflict by this Court of the recurring federal tax question of the meaning of "wages" is essential in order that uniform withholding standards may apply to employers throughout the nation and that employers will know in advance what these standards are.

2. Section 3402(a) of the Code requires an employer to withhold *only* upon payments of "wages", which are defined in Section 3401(a) as "all remuneration . . . *for services performed* by an employee for his employer. . . ." [Emphasis supplied.] However, the court of appeals held

[1] 540 F.2d at 302. The opinion of the court below was amended on September 2, 1976, to state in a footnote that ". . . no active judge favored a rehearing *in banc* on the question raised by the conflict of this opinion with that of the Fourth Circuit in *Royster* v. *United States*, 479 F.2d 387 (1973)."

that wages for withholding purposes include the "total package of remuneration, including salary, pension, paid vacation time and other remuneration. . . ."[2]

Obviously, all payments and benefits to an employee from the employer are attributable to the employment relationship and the employer's expectation that its employee will perform services for it; but never before has it been held that all payments and benefits to an employee constitute "wages", *i.e.*, remuneration for services performed. The decided cases have refused to hold that a variety of payments to an employee constitute "wages" subject to withholding.[3] Further, administrative practice over the years, made known through official interpretations outstanding for decades, recognizes that not every economic benefit provided to employees by their employer, including supper money for employees who work over-

[2] 540 F.2d at 302. The Fourth Circuit in *Royster* expressly rejected the position accepted by the court below because it "render[s] nugatory any distinction between" wages and income. 479 F.2d at 390.

[3] *See, e.g., Allstate Ins. Co.* v. *United States*, 530 F.2d 378 (Ct. Cl. 1976); *Stubbs, Overbeck & Associates, Inc.* v. *United States*, 445 F.2d 1142 (5th Cir. 1971); *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362 (Ct. Cl. 1971); *Humble Pipe Line Co.* v. *United States*, 442 F.2d 1353 (Ct. Cl. 1971); *Peoples Life Ins. Co.* v. *United States*, 373 F.2d 924 (Ct. Cl. 1967); *Acacia Mutual Life Ins. Co.* v. *United States*, 272 F.Supp. 188 (D.Md. 1967). Further, contrary to the apparent conclusion of the court of appeals, Section 3401(a) specifically excludes from "wages" all payments from qualified pension, profit-sharing and stock-bonus plans, even though such payments represent taxable income to the employee.

time, represents even taxable income—much less wages—to the employee.[4]

In addition, as observed by the Treasury Department in the Summary and Explanation cited in note 4, *supra*, in discussing withholding on fringe benefits (at p. J-9): "If we should attempt to include in the withholding base every economic benefit enjoyed by great numbers of employees, the operation of the system would be seriously jeopardized." The difficulties extend not only to the valuation of non-cash items but to determining the amount of cash items subject to withholding.[5]

Whether the view of the *Royster* court or that of the court below is the proper interpretation of "wages" should

[4] *See, e.g.*, O.D. 514, 2 Cum Bull. 90 (1920); Treasury Regulations §1.119-1(a)(2)(i); Discussion Draft of Proposed Regulations §1.61-16 on Employee Fringe Benefits, 40 Fed. Reg. 41118-22 (9/5/75); and Summary and Explanation of Discussion Draft of Proposed Regulations on Fringe Benefits. Daily Tax Report of September 4, 1975 (pp. J-5 through J-9), published by the Bureau of National Affairs, Inc. On December 17, 1976, Treasury Secretary Simon, in withdrawing the Discussion Draft, commented:

> "The myriad forms in which fringe benefits are provided and the difficulty of valuing those benefits, together with the undesirability of mandating the keeping of additional detailed records by employers and employees in certain cases, with the attendant costs and complexities involved, have caused me to conclude that the discussion draft should be withdrawn."

[5] Because of other offsetting deductions allowed to an employee, federal income taxes may not even be owed on the amount of meal reimbursements. *See* Rev. Rul. 69-592, 1969-2 Cum. Bull. 193. Apparently, on this basis, even the government does not withhold on per diem allowances for non-overnight trips. *See* Tax Management Memorandum, TMM 75-03, dated February 3, 1975, published by the Bureau of National Affairs.

be resolved by this Court at this time. Otherwise, the decision below is likely to encourage widespread litigation and uncertainty as to an employer's obligation to withhold upon employee payments and benefits attributable to the employment relationship.

3. The court below also erred by holding in effect that petitioner should be subject retroactively to the imposition of federal withholding tax obligations. The retroactive imposition of a withholding obligation is of particular concern because an employer, under the withholding tax provisions, is merely a conduit for the government in collecting federal taxes. The employer should not be forced to be in effect a guarantor of any federal tax deficiencies of its employees as a consequence of a subsequent decision denying a deduction to such employees.

As the record shows, it was reasonable for petitioner to believe that the payments in question were not "wages". First, these payments were in furtherance of the petitioner's business and, as the district court found, were not for services performed. Further, prior to the year the payments in question were made, the Eighth Circuit in *Hanson* v. *Commissioner*, 298 F.2d 391 (8th Cir. 1962), allowed a federal income tax deduction in the amount of meal expenses incurred during business trips which did not require the taxpayer to be away overnight. *In Ahrens* v. *United States*, 264 F.Supp. 518 (S.D. Ill. 1967), the court similarly allowed such a deduction to one of petitioner's own employees for noon meal expenses incurred by him in the year 1962 while on non-overnight trips for petitioner for which he was reimbursed.

While the deduction was subsequently disallowed in *United States* v. *Correll*, 389 U.S. 299 (1967), this Court did not hold the payments to be "wages" or subject to

withholding. Indeed, this Court's holding in *Correll* is based upon administrative convenience and does not suggest that any basis exists for treating the denial of the deduction as somehow resulting in the creation of a "wage" item.

By its decision below, the court of appeals has inequitably sanctioned the retroactive imposition of withholding tax and interest upon the petitioner, apparently as a matter of law, though petitioner had reason to believe it had no such withholding tax obligation. Even the Internal Revenue Service has not sought to go so far. *See* Rev. Rul. 69-592, 1969-2 Cum. Bull. 193. The question of an employer's potential liability to pay past taxes resulting from reimbursements not believed to be "wages" at the time paid should be decided by this Court to minimize the inequitable risks otherwise imposed upon employers in an atmosphere of considerable uncertainty. Where the withholding tax is involved, an employer is entitled to the clearest advance direction.

4. Both issues raised herein, namely the expansive definition given the term "wages" for purposes of withholding and the potential liability of an employer for retroactive imposition upon it of withholding tax obligations for payments belatedly characterized as "wages" are of wide significance and relevance. We believe that numerous companies have some type of meal reimbursement program in the furtherance of their businesses. In fact, prior to the time of preparing this Petition, the American Gas Association, an industry group comprised of more than 300 members (including gas distribution companies, combination gas and electric companies and gas transmission companies), announced that it would seek to file an amicus curiae brief in this case if certiorari is granted

because of the importance of the issues to its member companies.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

Appendix A. Findings of Fact and Conclusions of Law of the District Court, 405 F.Supp. 748.

Appendix B. Opinion of the Court of Appeals, 540 F.2d 300.

Appendix C. Judgment of the Court of Appeals.

Appendix D. Denial of Petition for Rehearing.

Appendix E. Relevant Statutes and Regulations.

APPENDIX A

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

Civ. No. 4920.

United States District Court,
S. D. Illinois, S. D.

Dec. 29, 1975.

Suit was brought by corporate employer for refund of deficiency assessed by federal government for additional withholding taxes and interest in connection with certain lunch payments to employees. The District Court, Harlington Wood, Jr., J., held that where employees, who were paid depending on their classification either $1.40 or actual lunch expenses for lunches eaten away from company while on company business, rendered no service to company during noon hour, lunch payments were unrelated to employee's specific job title, nature of his work or rate of pay, and payments could hardly be considered money making proposition for employees, such payments were not "wages" for services rendered and thus did not require withholding by employer.

Judgment for plaintiff.

Internal Revenue—1766.3

Where employees, who were paid depending on their classification either $1.40 or actual lunch expenses for lunches eaten away from company while on company business, rendered no service to company during noon hour, lunch payments were unrelated to employee's specific job title, nature of his work, or rate of pay, and as practical

matter such payments could hardly be considered money making proposition for employees, such payments were not "wages" for services rendered and thus did not require withholding by employer.

Sharon L. King, Isham, Lincoln & Beale, Chicago, Ill., for plaintiff.

Nafzinger & Otten, Kenneth H. Otten, Springfield, Ill., Michael von Mandel, Trial Atty., Tax Div., Dept. of Justice, Washington, D. C., Donald B. Mackay, U. S. Atty., Springfield, Ill., for defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

HARLINGTON WOOD, JR., *District Judge.*

This case was tried before the Court without a jury. Thereafter counsel filed briefs.

The issue is found for Plaintiff and against the Defendant.

That only issue is whether or not the Internal Revenue Code of 1954 required that the Plaintiff company withhold taxes on payments it made on occasion to some of its employees for lunch. If an employee was away from home and travelling on the company's business during the day and ate lunch wherever he was without returning for that purpose, the company paid the employee in one classification an amount not to exceed $1.40, and certain other employees an amount as reimbursement for the actual cost of the lunch. These classifications related only to the particular geographical division of the company where the employee worked, or his union status and are not relevant to the tax question. Overnight trips also are not involved. The company considered the lunch payments to be travel expenses not subject to withholding and therefore nothing was withheld by the company on these payments. The Government claims however that these lunch payments were additional wages and therefore subject to withholding. The Government assessed a deficiency against

the company in 1971 for additional withholding taxes together with interest for four taxable quarters in 1963 amounting to $25,188.50 in taxes with $11,427.22 in taxes, or a total amount of $36,615.72. The company paid this amount and brings this suit for refund.

There appears to be little dispute about the underlying facts.

The company is an Illinois corporation having its principal office in Springfield, Illinois, and is a public utility engaged in the generating, transmissions, distribution and sale of electric energy and the distribution and sale of natural gas in Illinois.

The company reimbursed its employees for legitimate travel expenses which included these lunch payments in accordance with its established policy. If the employee was on a required trip for the company's business, the employee made an accounting on a company form which he turned in to his supervisor for approval followed by payment by the company. For employees in one category this was not to exceed $1.40 regardless of the cost of the lunch, and for others the amount was reimbursement for actual lunch expenses. The evidence disclosed that depending on the individual and the circumstances the $1.40 rate was sometimes in excess of the actual lunch cost, but very often it was insufficient to cover the cost. Depending on where the employee was assigned on a particular day some would go home for lunch and thus not be entitled to the reimbursement; however, these employees who took their lunch from home with them on a company trip were also entitled to the payment. Even in 1963 the $1.40 rate was modest considering that many of these employees were men engaged in open air labor. As a practical matter, it could hardly be considered a money making proposition for an employee.

There are facts which this Court believes distinguishes this case from the case of the usual employee who leaves his office at noon to go out for lunch. The employee in

the present case is away from home in travel status. He renders no service to the company during his lunch. Usually the employee would not be at the actual work site, but at a restaurant in the vicinity. He was off duty during this time. His time was his own. The employee was, however, subject to call during the noon hour, but all the employees in this public utility business were generally subject to call, not just during the lunch break, at any time as emergencies might require. These lunch payments were unrelated to the employee's specific job title, the nature of his work or rate of pay. It appears that this lunch payment arrangement was beneficial and convenient for the company and served its business interest. It saved the company employee time otherwise spent in travelling back and forth as well as the usual travel expenses.

Against this factual background this Court is of the opinion that the Government's view that these payments were "wages" in this particular case requires a departure from the realities of business life and a vigorous stretching of the statute to try to include the lunch payments as being for services rendered to the company. *U. S.* v. *Correll*, 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537 (1967) relating to deductibility of travel expenses by an employee does not thereby automatically require withholding by the employer. The present case is not one where the company is asking that the Federal Treasury help finance its employees' meals.

There are some noncritical factual distinctions but this Court is persuaded by the views expressed in *Royster* v. *U. S.*, 479 F.2d 387 (4th Cir. 1973). The payments there under somewhat similar circumstances were held not to be remuneration for services performed to the employer. I believe the situation in this present case is substantially the same.

Therefore, the Plaintiff shall have judgment in the amount of $36,615.72 together with interest thereon.

APPENDIX B

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

No. 76-1277.

United States Court of Appeals,
Seventh Circuit.

Argued June 9, 1976.

Decided Aug. 17, 1976.*

As Amended Sept. 2, 1976.

Corporate employer brought suit for refund of deficiency assessed for additional withholding taxes and interest in connection with certain lunch payments to employees. The United States District Court for the Southern District of Illinois, Harlington Wood, Jr., J., 405 F.Supp. 748, rendered judgment against the Government, and it appealed. The Court of Appeals, Sprecher, Circuit Judge, held that reimbursements for employees' lunches eaten while on nonovernight trips away from their home areas constistituted "wages" under the income tax withholding provisions, and tax on those reimbursements thus had to be withheld by the employer.

Reversed.

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* This opinion has been circulated among all judges of this court in regular active service. Tone and Harlington Wood, Jr., Circuit Judges, not participating, no active judge favored a rehearing *in banc* on the question raised by the conflict of this opinion with that of the Fourth Circuit in *Royster* v. *United States*, 478 F.2d 387 (1973).

1. Internal Revenue—1766.3

Reimbursements for employees' lunches eaten while on nonovernight trips away from their home areas constituted "wages" under the income tax withholding provisions, and tax on those reimbursements thus had to be withheld by the employer. 26 U.S.C.A. (I.R.C.1954) § 3401(a).

See publication Words and Phrases for other judicial constructions and definitions.

2. Internal Revenue—555

Reimbursements made for meals on a nonovernight trip are nondeductible income.

3. Internal Revenue—341

Not all payments constituting income to an employee fall into the category of remuneration for employees services or "wages." 26 U.S.C.A. (I.R.C.1954) § 3401(a).

Scott P. Crampton, Asst. Atty. Gen., Alfred S. Lombardi, Atty., Tax Div., Dept. of Justice, Washington, D. C., Donald B. MacKay, U. S. Atty., Springfield, Ill., for defendant-appellant.

Sharon L. King, Chicago, Ill., for plaintiff-appellee.

Before FAIRCHILD, Chief Judge, and SWYGERT and SPRECHER, Circuit Judges.

SPRECHER, Circuit Judge.

[1] This case concerns whether reimbursements for employees' lunches eaten while on non-overnight trips away from their home areas are considered "wages" under the income tax withholding provisions, 26 U.S.C. § 3401(a) and thus whether tax on these reimbursements must be withheld by the employer.

I

Central Illinois Public Service Company (the company), a public utility, supplies electricity and natural gas to an extensive area of downstate Illinois. Because of the size of its service area, employees often have to travel away from their home base, both on day trips during normal business hours and on overnight trips. The company, in accord with a longstanding policy, reimburses its employees for legitimate expenses of transportation, meals and lodging when traveling on company business. In the present case, only reimbursements made for lunches eaten away from employee's normal duty area during nonovernight trips are at issue.

The company reimburses employees for these lunches if they are taken away from their normal work stations or job sites at the time of their noonday meal. The amount of reimbursement depends upon the employee's status. Union employees and operating employees of the Western Division (the only division of the company as yet ununionized) receive a flat rate of $1.40 per noonday meal eaten away from their normal post of duty. This is provided for in the union's collective bargaining agreement. The full $1.40 can be, and often is, claimed regardless of the amount actually spent on lunch—in many cases the reimbursement is claimed even when the employee brings his lunch from home. Other employees—those on a salaried basis—are reimbursed for their actual expenses up to $25 per meal. During 1963, the Tax year in question, the company paid its employees $139,936.12 in reimbursements for such noonday meals. The company did not withhold income tax for its employees with respect to this sum.

In 1971, the District Director of Internal Revenue Service assessed against the company withholding taxes for these noon-meal reimbursements (plus interest thereon) totaling $36,615.72. The company paid the sum and sued for a refund. The district court held that the reimbursements were not "wages" under 26 U.S.C. § 3401(a) relying primarily on a case from the Fourth Circuit, *Roy-*

ster Co. v. *United States*, 479 F.2d 387 (4th Cir. 1973). Thus it held that the reimbursements were not subject to withholding for income tax purposes and rendered judgment for the plaintiffs. The government appealed.

II

Under the Internal Revenue Code provisions requiring collection of income tax at its source, 26 U.S.C. §§ 3401 *et seq.*, an employer must withhold from an employee and pay to the government a certain portion of the employee's "wages." Section 3401(a) defines "wages" as "all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash . . . ." The regulations further make clear that the name by which the remuneration is designated is immaterial, as is the basis upon which it is paid.[1] The question which this case presents is whether reimbursements for noon meals on non-overnight trips constitute "wages" as so defined.

[2, 3] Clearly, these reimbursements are non-deductible income to the employees. In *United States* v. *Correll*, 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537 (1967), the Supreme Court upheld the ruling of the Commissioner

[1] Treas.Reg. § 31.3401(a)-1(a) provides:

(1) The terms "wages" means all remuneration for services performed by an employee for his employer unless specifically excepted under section 3401(a) or excepted under section 3402(e).

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

(3) The basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, monthly, or annually.

(*see, e. g.*, Treas.Reg. § 1.162—17(b)(3)(ii)) that expenses incurred for meals on business trips are deductible only if the trip requires sleep or rest (i. e., and overnight stay). Thus, these reimbursements made for meals on a non-overnight trip are non-deductible income. *Wilson* v. *United States*, 412 F.2d 694 (1st Cir. 1969) (reimbursement for "mid-shift" meal of state trooper, given if the trooper was more than 10 miles from home barracks, held non-deductible income). However, as the government concedes, not all payments constituting income to an employee fall into the category of remuneration for employee services or "wages."

The Supreme Court although not having interpreted this particular section, on at least two occasions has given broad definition to that which constitutes remuneration for employee services. In *Commissioner* v. *LoBue*, 351 U.S. 243, 247, 76 S.Ct. 800, 803, 100 L.Ed. 1142 (1956), the Court wrote:

> When assets are transferred by an employer to an employee to secure better services they are plainly compensation. . . . LoBue received a very substantial economic and financial benefit from his employer prompted by the employer's desire to get better work from him. This is "compensation for personal service" within the meaning of § 22(a).

And in *Social Security Board* v. *Nierotko*, 327 U.S. 358, 365-66, 66 S.Ct. 637, 641, 90 L.Ed. 718 (1946), the Court wrote:

> We think that "service" . . . means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.

These statements lead us to agree with the view taken by the Second Circuit in *Educational Fund of the Electrical Industry* v. *United States*, 426 F.2d 1053 (2d Cir. 1970). In that case, the question presented was whether $140 paid to electricians in lieu of wages for successfully

attending a one-week course at a school established by the union constituted "wages" for withholding purposes. The court held that it did.

> The $140 payments to those who attended the school represented part of the benefit package which was negotiated as part of the wage structure under the collective bargaining agreement in effect between the employers and the union as representative of the electrical workers. The payments ultimately derived from the employers and represented a portion of the agreed upon remuneration for services performed by the employees within the intent of Section 3401(a), just as do payments from pension and vacation funds.

Id., at 1056. This expansive definition of "wages" seems appropriate and harmonizes well with the underlying purposes of the withholding tax system to collect income at its source and to prevent unexpected burdensome tax liabilities come April 15.[2]

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[2] This view accords well with the legislative history of a similar provision, the definition of "wages" under the social security tax system, 26 U.S.C. § 3121, a definition held to have "the same essential meaning" as that for withholding. *Royster Co.* v. *United States,* 479 F.2d 387, 390 (4th Cir. 1973) The House Report on the initial Social Security Bill, H.R. 7260, 74th Cong., 1st Sess., stated:

> Wages include not only the cash payments made to the employee for work done, but also compensation for services in any other form, such as room, board, etc.

H.R.Rep. No. 615, 74th Cong., 1st Sess., p. 32 (1939—2 Cumm.Bull. 600, 606). The Senate Report contained similar language:

> The term "wages" is defined to mean all remuneration for employment, including the cash value of all remuneration paid in any other medium than cash. *That is, in addition to money payments, it includes payments in kind, rent, food, lodging, etc.*

S.Rep. No. 628, 74th Cong., 1st Sess., p. 49 (1939—2 Cum. Bull. 611, 623) (emphasis supplied).

Having found this view appropriate, the opinion of the Fourth Circuit in *Royster Co.* v. *United States,* 479 F.2d 387 (4th Cir. 1973), appears unpersuasive. The court in *Royster* held that payments to salesmen to reimburse them for the cost of their noon meals while in their sales territory did not constitute "wages" for withholding purposes. The government concedes, as it must, that *Royster* is not meaningfully distinguishable from the present case. The *Royster* court took a narrow view of the meaning of "remuneration for services" holding that because the salesmen "performed no services while eating, directly or indirectly," the reimbursement for the meal was not remuneration for services. *Id.,* at 391.

Remuneration for services cannot be viewed this narrowly. The employment relationship is a two-sided bargain, with the employee's services being given for a total package of remuneration, including salary, pension, paid vacation time and other remuneration such as reimbursed lunches. Clearly, in the present case, the employer had no obligation to pay for employee lunches. And certainly, the employee gains by the payment; otherwise, the employee would have to pay for lunch himself. If cannot be doubted that the lunch reimbursements are part of a total package of remuneration designed to attract and hold good employees to the company. As such, they must be considered "wages" under 26 U.S.C. § 3401(a) for withholding tax purposes.[3]

---

[3] The company agrees that whatever these reimbursements are classified as, they are still excludable under Treas.Reg. § 31.3401(a)-1(b)(2) concerning traveling expenses. The regulation provides in relevant part:

> Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding.

However, to be travel expenses, the employee must be on travel status; that is, he must be on an overnight trip.

Since the noon meal reimbursements at issue in this case are "wages," the employer is liable for withholding tax on them. Thus, the assessment of the District Director against the company was proper. The judgment of the district court is reversed.

Reversed.

---

[3] (Continued)
United States v. *Correll*, 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537 (1967). Here the employees were not traveling overnight, and thus, the reimbursements were not travel expenses. Nor were the reimbursements necessary business expenses, for an employee's lunch without more, is not an "ordinary and necessary expense . . . incurred in the business of the employer."

APPENDIX C

Opinion by Judge Sprecher

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

August 17, 1976
Before
Hon. THOMAS E. FAIRCHILD, *Chief Judge*
Hon. LUTHER M. SWYGERT, *Circuit Judge*
Hon. ROBERT A. SPRECHER, *Circuit Judge*

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

No. 76-1277 vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Illinois
Civil No. 4920
HARLINGTON WOOD, JR., *Judge*

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Illinois and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, in accordance with the opinion of this Court filed this date.

APPENDIX D

UNITED STATES COURT OF APPEALS

For the Seventh Circuit

Chicago, Illinois 60604

November 4, 1976

Before

Hon. THOMAS E. FAIRCHILD, *Chief Judge*

Hon. LUTHER M. SWYGERT, *Circuit Judge*

HON. ROBERT A. SPRECHER, *Circuit Judge*

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

No. 76-1277 vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Illinois.

No. 4920

HARLINGTON WOOD, JR., *Judge*

On consideration of the petition for rehearing filed in the above-entitled cause, all of the members of the panel having voted to deny a rehearing,

IT IS ORDERED that the petition for rehearing in the above-entitled cause be, and the same is hereby, DENIED.

APPENDIX E

Internal Revenue Code of 1954:

SEC. 3401. Definitions.

(a) Wages.

For purposes of this chapter, the term "wages" means all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash . . . .

• • • • • •

(26 U.S.C. 1958 ed., Sec. 3401)

SEC. 3402. Income tax collected at source.

(a) Requirement of withholding.

Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables. . . .

• • • • •

(26 U.S.C. 1958 ed., Sec. 3402)

Treasury Regulations:

Sec. 31.3401(a)-1 Wages—

(a) In general.

(1) the term "wages" means all remuneration for services performed by an employee for his employer unless specifically exempted under section 3401(a) or excepted under section 3402(e).

• • • • •

(b) Certain specific items—

• • • • •

(2) Traveling and other expenses.

Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment.

• • • • •

(T.D. 6259, 1957-2 Cum. Bull. 645)

Sec. 31.3121(a)-1 Wages—

• • • • •

(h) Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment.

• • • • •

(T.D. 6516, 25 Fed. Reg. 13032 (12/20/60))

Supreme Court, U. S.
FILED
JUN 14 1977
MICHAEL RODAK, JR., CLERK

APPENDIX

In the

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

Petition For Certiorari Filed February 1, 1977
Certiorari Granted May 2, 1977

The Scheffer Press, Inc.—(312) 263-6850

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1976

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

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APPENDIX

DISTRICT COURT DOCKET

Date	*Filings-Proceedings*
11/ 4/71	Complaint filed.
11/ 4/71	Summons issued. Original Summons and five copies, with copies of Complaint attached to U.S. Marshal for service.
11/ 9/71	Original Summons returned, executed Nov. 8, 1971, filed.
1/ 6/72	Answer of Defendant, United States of America, filed.
9/18/72	Interrogatories to Plaintiff, filed.
10/12/72	Answer of William H. Kuntzi to Defendant's Interrogatories, filed.

10/18/72 Affidavit of service of interrogatories filed on Oct. 12, 1972, filed.
3/22/74 Pre-trial set for Thursday, June 27, 1974 at 4:30 p.m.
3/22/74 Clerk's Notice of pre-trial setting mailed.
6/26/74 Pre-trial conference reset for Friday, Sept. 13, 1974 at 1:00 p.m. continued on Court's Motion for good cause shown.
7/ 5/74 Clerk's Notice of setting for Sept. 13, 1974, mailed.
9/ 3/74 Answer of United States of America, filed.
9/13/74 Interrogatories to Plaintiff, filed.
9/13/74 Pre-trial conference held.
9/13/74 Bench Trial set for Thursday, Dec. 19, 1974 at 9:00 a.m. at Springfield.
9/13/74 Clerk's Notice of Bench Trial setting mailed.
10/ 7/74 Motion of Plaintiff for Extension of Time Within Which to Answer Interrogatories to Plaintiff filed.
10/11/74 Motion of Plaintiff for Extension of Time Within Which to Answer Interrogatories for 15 days from Oct. 13, 1974, or to Oct. 28, 1974, allowed.
10/25/74 Pre-trial Order filed and entered. Bench trial Dec. 19, 1974, at 9:00 a.m.
10/29/74 Answer of William F. Grant to Defendant's Interrogatories filed.
12/11/74 Plaintiff's Trial Brief filed.
12/12/74 Defendant's Trial Memorandum filed.
12/17/74 Subpoena filed. Served on Joseph M. Roley 12/16/74.
12/17/74 Subpoena filed. Served on Gerard A. Gardner, Sr., 12/16/74.
12/17/74 Subpoena filed. Served on C.H. (Joe) Loring 12/16/74.

12/17/74 Subpoena filed. Served on Jack B. Burdick, Asst. Treas. and Comptroller of IL Power Co.
12/17/74 Subpoena filed. Returned 12/17/74, Jean Molohan not served on vacation, will return 1/6/75.
12/19/74 Stipulation filed.
12/19/74 Both parties in court with counsel; cause is called for bench trial; both sides answer ready; opening statements heard; evidence presented on behalf of Plaintiff; Plainttiff rests; evidence presented on behalf of Government; Government rests; Oral motion to withdraw Attorney Paul Harris, appearance as counsel for Plaintiff; Court allows motion; Rebuttal evidence heard; both sides rest; closing arguments heard; both sides rest; brief to be submitted by Plaintiff—January 20, 1975; Reply brief to be submitted by Government (Feb. 10, 1975). Wood, Judge.
12/19/74 Subpoena on behalf of Plaintiff (Lawrence O. Minder) Date of Service 12/19/74 filed.
12/24/74 Subpoena on behalf of Plaintiff (J.B. Burdick) filed (Date of Service 12/19/74).
1/20/75 Motion for Extension of Time Within which to File Brief on the Law for Plaintiff from Jan. 20, 1975 to Jan. 27, 1975, filed.
1/20/75 Motion of Plaintiff for extension of time within which to file brief to January 27, 1975, allowed. (Wood, Judge)
1/27/75 Brief on the Law for Plaintiff, filed.
1/27/75 Motion of Plaintiff for Leave to File Reply Brief, filed.
1/29/75 Defendant's Opposition to Plaintiff's Motion for Leave to File Reply Brief filed.

2/ 5/75	Plaintiff given leave to file Reply Brief in 10 days after Defendant's Brief is filed. (Wood, Judge)
2/19/75	Defendant's Post Trial Memorandum filed.
2/27/75	Reply to Defendant's Post Trial Memorandum filed.
12/29/75	Findings of Fact and Conclusions of Law and directions for entering Judgment in favor of the Plaintiff and against the Defendant in the amount of $36,615.72 together with interest at the lawful rate and costs.
12/29/75	Judgment filed and entered. Judgment entered in favor of Central Illinois Public Service Company and against the United States of America for the sum of $36,615.72, plus the legal rate of interest and costs of suit.
12/29/75	CLOSED J.S. 6 prepared and mailed 1/3/76.
1/27/76	Court Reporter's Transcript of proceedings had and evidence taken on Dec. 19, 1974, filed. (Original and one copy)
2/26/76	Notice of Appeal filed by United States. Copy of Notice of Appeal mailed to Sharon L. King, Atty and Nafiger & Otten, Atty.
2/26/76	Short Record on Appeal mailed to the U.S. Court of Appeals, 7th Circuit.
3/16/76	Memo from Donald B. Mackay, U.S. Attorney, advising appeal due in Chicago by March 31, 1976.
3/23/76	Certified Copy of Order dated Mar. 18, 1976 from U.S. Court of Appeals, 7th Circuit, setting up procedural schedule—RECORD DUE IN COURT OF APPEALS BY APRIL 1, 1976.

COURT OF APPEALS DOCKET

Date	*Filings-Proceedings*
3/18/76	Entered Order adopting the following procedural schedule: (1) Record on appeal due 4/1/76. (2) Appellant's brief due 4/16/76. (3) Appellee's brief due 5/14/76. (4) Appellant's reply brief due 5/26/76. (5) Appeal will be set for O.A. at some time between 6/1/76 and 6/18/76. Further ordered that U.S. Dist. Clerk for the So. Dist. of IL prepare the entire record on appeal. Issued certified copies of Order to U.S. Dist. Clerk, Court Reporter and J. Wood.
4/19/76	Filed 15c of Appellant's Brief—svc.
5/14/76	Filed 15c of Appellee's Brief—svc.
5/24/76	Entered order setting appeal for oral argument on Wed., 6/9/76, 9:30 a.m. Oral argument limited to 20 mins/side.
5/28/76	Filed 15c of Appellant's Reply Brief—svc.
6/ 9/76	Heard and taken under advisement.
8/17/76	Entered final judgment order REVERSING, with costs.
8/17/76	Filed opinion by Judge Sprecher.
8/23/76	Filed 0&1c appellant's bill of costs in the amount of $111.05.
8/25/76	Filed 0&3c appellee's motion for an extension of time to file petition for petition for rehearing-aff.
9/ 1/76	Entered order granting motion of appellee, rehearing due 9/10/76.

9/ 2/76 Entered order amending opinion—an asterisk be added on page 1 at the end of "Decided August 17, 1976," & footnote be added at bottom of page 1 as follows:
* This opinion has been circulated among all judges of this court in regular active service. Judges Tone & Wood not participating, no active judge favored a rehearing in banc on the question raised by the conflict of this opinion with that of the 4th Cir. in Royster v. United States, 479 F.2d 387 (1973).

9/10/76 Filed 15c petition for rehearing-service-distributed.

11/ 4/76 Entered order denying petition for rehearing.

11/12/76 MANDATE ISSUED

2/ 7/77 Filed notice of filing petition for cert., Supreme Court docket No. 76-1058.

UNITED STATES DISTRICT COURT FOR THE
Southern District Of Illinois
Southern Division

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant.

Civ. No. 4920.

COMPLAINT
[Filed November 4, 1971]

Now comes the plaintiff, Central Illinois Public Service Company, an Illinois corporation, by its attorneys, and complains of the defendant, the United States of America, and says:

1. Plaintiff is a corporation organized and existing under the laws of the State of Illinois, and having its principal office and place of business at 607 East Adams Street, Springfield, Illinois.

2. The defendant is the United States of America.

3. This is an action for recovery of internal revenue taxes and this Court has jurisdiction by reason of Title 28, U.S.C., Section 1346(a).

4. Plaintiff is, and at all times here involved was, a regulated public utility primarily engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas at retail in the State of Illinois. During the year 1963, plaintiff employed approximately 1,900 employees.

5. Recovery is sought of federal employment taxes for the taxable periods ended March 31, 1963, June 30, 1963, September 30, 1963, and December 31, 1963. Plain-

tiff timely paid employment taxes and timely filed Forms 941, Employer Quarterly Federal Tax Return, with the District Director of Internal Revenue, Springfield, Illinois (hereinafter sometimes called the "District Director") for the taxable periods ended March 31, 1963, June 30, 1963, September 30, 1963, and December 31, 1963, respectively. The tax liability timely paid by plaintiff and reported on such returns for such periods is as follows:

Taxable Period Ended:	Withholding Tax	FICA Tax	Total Withholding and FICA Tax
March 31, 1963	$491,730.13	$251,567.72	$743,297.85
June 30, 1963	471,429.02	231,230.68	702,659.70
September 30, 1963	511,403.31	134,213.31	645,616.62
December 31, 1963	491,927.41	37,716.47	529,643.88

On or about April 2, 1971, the District Director assessed against plaintiff additional withholding taxes, together with interest thereon, for each of the taxable periods here involved in the following amounts:

Taxable Period Ended:	Witholding Tax Assessed	Interest Assessed	Total
March 31, 1963	$ 6,337.04	$ 3,013.22	$ 9,350.26
June 30, 1963	6,700.35	3,084.36	9,784.71
September 30, 1963	6,711.27	2,988.72	9,699.99
December 31, 1963	5,439.84	2,340.92	7,780.76
Total	$25,188.50	$11,427.22	$36,615.72

On April 12, 1971, plaintiff paid to the District Director on account of such assessments the sum of $36,615.72. Plaintiff alleges that such additional withholding taxes and the interest thereon were erroneously and illegally assessed and collected and demands recovery of $36,615.72, together with such interest as is allowed by law.

6. On April 16, 1971, plaintiff filed with the District Director a claim for refund, a copy of which is attached hereto, marked Exhibit A and made a part hereof. Six months have elapsed since such claim for refund was filed and no action has been taken thereon.

7. During the taxable periods ended March 31, 1963, June 30, 1963, September 30, 1963, and December 31, 1963, plaintiff reimbursed employees for meal expenses incurred while they were traveling on the business of plaintiff on trips which did not keep the employees away from home overnight. Plaintiff did not withhold federal income tax on such reimbursements since the reimbursements were not "wages" within the meaning of Section 3401 of the Internal Revenue Code of 1954 and thus were not subject to income tax withholding under Section 3402 of the Code. The District Director erroneously treated such reimbursements as "wages" subject to withholding for federal income tax purposes and erroneously and illegally collected from plaintiff federal withholding tax in the amount of $25,188.50 and interest thereon in the amount of $11,427.22, no part of which was deducted or withheld by plaintiff from its employees. Plaintiff is entitled to recover $36,615.72, together with interest thereon as allowed by law.

8. Plaintiff has overpaid federal employment taxes for the taxable periods ended March 31, 1963, June 30, 1963, September 30, 1963, and December 31, 1963, is the sole owner of the aforementioned claim for refund attached hereto as Exhibit A, and has made no assignment of that claim.

Wherefore, plaintiff demands judgment in the amount of $36,615.72, plus such interest and costs as are allowed

by law, and such other relief as the Court may deem just and equitable.

Central Illinois Public Service Company
By /s/ Sharon L. King
Sharon L. King
Isham, Lincoln & Beale
One First National Plaza
Chicago, Illinois 60670
Area Code 312—786-7500
Attorneys for Plaintiff

Of Counsel:
Paul V. Harris
20 North Wacker Drive
Chicago, Illinois 60606

Form 843 (Rev. Dec. 1970) Department of the Treasury Internal Revenue Service

Claim

Director's Stamp (Date received)

RECEIVED
APR 20 1971

The Internal Revenue Service will indicate in the block below the kind of claim filed, and fill in, where required.

☐ Refund of Taxes Illegally, Erroneously, or Excessively Collected.
☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
☐ Abatement of Tax Assessed (not applicable to income, estate or gift taxes).

Please Type or Print Plainly

Name of taxpayer or purchaser of stamps: Central Illinois Public Service Company

Number and street: 607 East Adams Street

City or town, State, and ZIP code: Springfield, Illinois 62701

Fill in applicable items—Use attachments if necessary

a. Your social security number | Wife's number, if joint return | b. Employer identification number (if any): 37-0211300

c. Internal Revenue Service office where return (if any) was filed: Springfield, Ill.

d. Name and address shown on return, if different from above

e. Period—If tax is reported on annual basis, prepare separate form for each taxable year: from January 1 1963 to December 31 19 63

f. Kind of tax: Employment

g. Amount of assessment: $ 2,657,833.77

Dates of payment: 3/31/63, 6/30/63, 9/30/63, 12/31/63 and 4/12/71.

h. Date stamps were purchased from Government

i. Amount to be refunded (if income tax, complete computation below): $ 36,615.72*

j. Amount to be abated (not applicable to income, estate, or gift taxes): $

k. The claimant believes that this claim should be allowed for the following reasons:

The taxpayer is not liable for payment of tax under Section 3403 of the Internal Revenue Code of 1954 on reimbursements to its employees for meal expenses incurred while traveling on the business of the taxpayer on trips which did not keep the employees away from home overnight since these reimbursements were not "wages" within the meaning of Section 3401 of the Code and thus were not subject to income tax withholding under Section 3402 of the Code. The District Director erroneously treated such payments as "wages" subject to withholding for federal income tax purposes and erroneously asserted liability against taxpayer for payment of tax under Section 3403 with respect to such reimbursements.

* or such greater amount as may be legally refundable.

Computation of Income Tax Refund	Income Tax
1 Tax withheld	
2 Estimated tax paid	
3 Tax paid with original return	
4 Any additional income tax paid	
5 Total tax paid (add lines 1–4)	
6 Less: Your computation of correct tax	
7 Amount of overpayment	
8 Amount previously refunded	
9 Net overpayment (enter in item i above)	

Under penalties of perjury, I declare that I have examined this claim, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete.

Central Illinois Public Service Company
Signed, W. H. Kuntzi
Dated April 16, 19 71 W. H. Kuntzi, Controller

See instructions on reverse. Form 843 (Rev. 12-70)

Exhibit A

IN THE
United States District Court For The
Southern District Of Illinois
Southern Division

[Title Omitted in Printing]

ANSWER

[Filed January 6, 1972]

Comes now the defendant, the United States of America by its attorney, Donald B. Mackay, United States Attorney for the Southern District of Illinois, for its answer to the complaint, states as follows:

1. Admits the allegations contained in paragraph 1 of the complaint.

2. Admits the allegations contained in paragraph 2 of the complaint.

3. Admits the allegations contained in paragraph 3 of the complaint.

4. Admits the allegations contained in paragraph 4 of the complaint.

5. Admits the allegations contained in paragraph 5 of the complaint, except denies the allegation that such additional withholding taxes for the four quarters of 1963 and interest thereon were erroneously and illegally assessed and collected.

6. Admits the allegations contained in paragraph 6 of the complaint, except denies every allegation contained in said claim for refund, Exhibit A, not otherwise admitted herein and specifically avers that said claim for refund was rejected on December 7, 1971.

7. Admits the allegations contained in paragraph 7 of the complaint, except denies the allegations that:

(a) the reimbursements were not "wages" within the meaning of Section 3401 of the Internal Revenue Code of 1954 and thus were not subject to income tax withholding under Section 3402 of the Code;

(b) the District Director erroneously treated such reimbursements as "wages" subject to withholding for federal income tax purposes and erroneously and illegally collected from plaintiff federal withholding tax in the amount of $25,188.50, and interest thereon in the amount of $11,427.22; and

(c) plaintiff is entitled to recover $36,615.72, plus interest according to law.

8. Denies the allegations contained in paragraph 8 of the complaint, except admits that plaintiff is the sole owner of the claim for refund and has made no assignment of that claim.

Wherefore, the defendant prays that the claim be dismissed and that judgment be entered for the defendant, together with costs.

.....
United States Attorney

Of Counsel:
/s/ Michael von Mandel
Michael von Mandel
Trial Attorney
Tax Division
Department of Justice
Washington, D.C. 20530

[Certificate of Service omitted in printing]

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

Civ. No. 4920.

United States District Court,
S. D. Illinois, S. D.
Dec. 29, 1975.

Suit was brought by corporate employer for refund of deficiency assessed by federal government for additional withholding taxes and interest in connection with certain lunch payments to employees. The District Court, Harlington Wood, Jr., J., held that where employees, who were paid depending on their classification either $1.40 or actual lunch expenses for lunches eaten away from company while on company business, rendered no service to company during noon hour, lunch payments were unrelated to employee's specific job title, nature of his work or rate of pay, and payments could hardly be considered money making proposition for employees, such payments were not "wages" for services rendered and thus did not require withholding by employer.

Judgment for plaintiff.

Internal Revenue—1766.3

Where employees, who were paid depending on their classification either $1.40 or actual lunch expenses for lunches eaten away from company while on company business, rendered no service to company during noon hour, lunch payments were unrelated to employee's specific job title, nature of his work, or rate of pay, and as practical matter such payments could hardly be considered money making proposition for employees, such payments were

not "wages" for services rendered and thus did not require withholding by employer.

Sharon L. King, Isham, Lincoln & Beale, Chicago, Ill., for plaintiff.

Nafzinger & Otten, Kenneth H. Otten, Springfield, Ill., Michael von Mandel, Trial Atty., Tax Div., Dept. of Justice, Washington, D.C., Donald B. Mackay, U.S. Atty., Springfield, Ill., for defendant.

FINDINGS OF FACT AND
CONCLUSIONS OF LAW

Harlington Wood, Jr., District Judge.

This case was tried before the Court without a jury. Thereafter counsel filed briefs.

The issue is found for Plaintiff and against the Defendant.

That only issue is whether or not the Internal Revenue Code of 1954 required that the Plaintiff company withhold taxes on payments it made on occasion to some of its employees for lunch. If an employee was away from home and traveling on the company's business during the day and ate lunch wherever he was without returning for that purpose, the company paid the employee in one classification an amount not to exceed $1.40, and certain other employees an amount as reimbursement for the actual cost of the lunch. These classifications related only to the particular geographical division of the company where the employee worked, or his union status and are not relevant to the tax question. Overnight trips also are not involved. The company considerd the lunch payments to be travel expenses not subject to withholding and therefore nothing was withheld by the company on these payments. The Government claims however that these lunch payments were additional wages and therefore subject to

withholding. The Government assessed a deficiency against the company in 1971 for additional withholding taxes together with interest for four taxable quarters in 1963 amounting to $25,188.50 in taxes with $11,427.22 in taxes, or a total amount of $36,615.72. The company paid this amount and brings this suit for refund.

There appears to be little dispute about the underlying facts.

The company is an Illinois corporation having its principal office in Springfield, Illinois, and is a public utility engaged in the generating, transmissions, distribution and sale of electric energy and the distribution and sale of natural gas in Illinois.

The company reimbursed its employees for legitimate travel expenses which included these lunch payments in accordance with its established policy. If the employee was on a required trip for the company's business, the employee made an accounting on a company form which he turned in to his supervisor for approval followed by payment by the company. For employees in one category this was not to exceed $1.40 regardless of the cost of the lunch, and for others the amount was reimbursement for actual lunch expenses. The evidence disclosed that depending on the individual and the circumstances the $1.40 rate was sometimes in excess of the actual lunch cost, but very often it was insufficient to cover the cost. Depending on where the employee was assigned on a particular day some would go home for lunch and thus not be entitled to the reimbursement; however, these employees who took their lunch from home with them on a company trip were also entitled to the payment. Even in 1963 the $1.40 rate was modest considering that many of these employees were men engaged in open air labor. As a practical matter,

it could hardly be considered a money making proposition for an employee.

There are facts which this Court believes distinguishes this case from the case of the usual employee who leaves his office at noon to go out for lunch. The employee in the present case is away from home in travel status. He renders no service to the company during his lunch. Usually the employee would not be at the actual work site, but at a restaurant in the vicinity. He was off duty during this time. His time was his own. The employee was, however, subject to call during the noon hour, but all the employees in this public utility business were generally subject to call, not just during the lunch break, at any time as emergencies might require. These lunch payments were unrelated to the employee's specific job title, the nature of his work or rate of pay. It appears that this lunch payment arrangement was beneficial and convenient for the company and served its business interest. It saved the company employee time otherwise spent in traveling back and forth as well as the usual travel expenses.

Against this factual background this Court is of the opinion that the Government's view that these payments were "wages" in this particular case requires a departure from the realities of business life and a vigorous stretching of the statute to try to include the lunch payments as being for services rendered to the company. *U. S.* v. *Correll,* 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537 (1967) relating to deductibility of travel expenses by an employee does not thereby automatically require withholding by the employer. The present case is not one where the company is asking that the Federal Treasury help finance its employees' meals.

There are some noncritical factual distinctions but this Court is persuaded by the views expressed in *Royster* v. *U. S.*, 479 F.2d 387 (4th Cir. 1973). The payments there under somewhat similar circumstances were held not to be remuneration for services performed to the employer. I believe the situation in this present case is substantially the same.

Therefore, the Plaintiff shall have judgment in the amount of $36,615.72 together with interest thereon.

UNITED STATES DISTRICT COURT
For The
Southern District of Illinois—Southern Division

Civil Action File No. 4920

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Plaintiff,

v.

UNITED STATES OF AMERICA,
Defendant

JUDGMENT

This action came on for trial before the Court, Honorable Harlington Wood, Jr., United States District Judge, presiding, and the issues having been duly tried and a decision having been duly rendered,

It is Ordered and Adjudged that the plaintiff, Central Illinois Public Service Company recover of the defendant, United States of America the sum of Thirty-six Thousand Six Hundred Fifteen and 72/100 Dollars ($36,615.72), with interest thereon at the legal rate as provided by law, and its costs of action.

Dated at Springfield, Illinois ....., this 29th ..... day of December ....., 1975.

/s/ William J. Littell
William J. Littell
Clerk of Court

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA,
Defendant-Appellant.

No. 76-1277.

United States Court of Appeals,
Seventh Circuit.

Argued June 9, 1976.

Decided Aug. 17, 1976*

As Amended Sept. 2, 1976.

Corporate employer brought suit for refund of deficiency assessed for additional withholding taxes and interest in connection with certain lunch payments to employees. The United States District Court for the Southern District of Illinois, Harlington Wood, Jr., J., 405 F.Supp. 748, rendered judgment against the Government, and it appealed. The Court of Appeals, Sprecher, Circuit Judge, held that reimbursements for employees' lunches eaten while on nonovernight trips away from their home areas constistituted "wages" under the income tax withholding provisions, and tax on those reimbursements thus had to be withheld by the employer.

Reversed.

---

* This opinion has been circulated among all judges of this court in regular active service. TONE and HARLINGTON WOOD, JR., Circuit Judges, not participating, no active judge favored a rehearing *in banc* on the question raised by the conflict of this opinion with that of the Fourth Circuit in *Royster* v. *United States*, 478 F.2d 387 (1973).

1. Internal Revenue—1766.3

Reimbursements for employees' lunches eaten while on nonovernight trips away from their home areas constituted "wages" under the income tax withholding provisions, and tax on those reimbursements thus had to be withheld by the employer. 26 U.S.C.A. (I.R.C. 1954) § 3401(a).

See publication. Words and Phrases for other judicial constructions and definitions.

2. Internal Revenue—555

Reimbursements made for meals on a nonovernight trip are nondeductible income.

3. Internal Revenue—341

Not all payments constituting income to an employee fall into the category of remuneration for employees services or "wages." 26 U.S.C.A. (I.R.C. 1954) § 3401(a).

Scott P. Crampton, Asst. Atty. Gen., Alfred S. Lombardi, Atty., Tax Div., Dept. of Justice, Washington, D. C., Donald B. MacKay, U. S. Atty., Springfield, Ill., for defendant-appellant.

Sharon L. King, Chicago, Ill., for plaintiff-appellee.

Before FAIRCHILD, Chief Judge, and SWYGERT and SPRECHER, Circuit Judges.

SPRECHER, Circuit Judge.

[1] This case concerns whether reimbursements for employees' lunches eaten while on non-overnight trips away from their home areas are considered "wages" under the income tax withholding provisions, 26 U.S.C. § 3401(a) and thus whether tax on these reimbursements must be withheld by the employer.

I

Central Illinois Public Service Company (the company), a public utility, supplies electricity and natural gas to an extensive area of downstate Illinois. Because of the size of its service area, employees often have to travel away from their home base, both on day trips during normal business hours and on overnight trips. The company, in accord with a longstanding policy, reimburses its employees for legitimate expenses of transportation, meals and lodging when traveling on company business. In the present case, only reimbursements made for lunches eaten away from employee's normal duty area during non-overnight trips are at issue.

The company reimburses employees for these lunches if they are taken away from their normal work stations or job sites at the time of their noonday meal. The amount of reimbursement depends upon the employee's status. Union employees and operating employees of the Western Division (the only division of the company as yet ununionized) receive a flat rate of $1.40 per noonday meal eaten away from their normal post of duty. This is provided for in the union's collective bargaining agreement. The full $1.40 can be, and often is, claimed regardless of the amount actually spent on lunch—in many cases the reimbursement is claimed even when the employee brings his lunch from home. Other employees—those on a salaried basis—are reimbursed for their actual expenses up to $25 per meal. During 1963, the Tax year in question, the company paid its employees $139,936.12 in reimbursements for such noonday meals. The company did not withhold income tax for its employees with respect to this sum.

In 1971, the District Director of Internal Revenue Service assessed against the company withholding taxes for these noon-meal reimbursements (plus interest thereon)

totaling $36,615.72. The company paid the sum and sued for a refund. The district court held that the reimbursements were not "wages" under 26 U.S.C. § 3401(a) relying primarily on a case from the Fourth Circuit, *Royster Co.* v. *United States,* 479 F.2d 387 (4th Cir. 1973) Thus it held that the reimbursements were not subject to withholding for income tax purposes and rendered judgment for the plaintiffs. The government appealed.

II

Under the Internal Revenue Code provisions requiring collection of income tax at its source, 26 U.S.C. §§ 3401 *et seq.,* an employer must withhold from an employee and pay to the government a certain portion of the employee's "wages." Section 3401(a) defines "wages" as "all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash . . . ." The regulations further make clear that the name by which the remuneration is designated is immaterial, as is the basis upon which it is paid.[1] The question which this

[1] Treas. Reg. § 31.3401(a)-1(a) provides:

(1) The terms "wages" means all remuneration for services performed by an employee for his employer unless specifically excepted under section 3401(a) or excepted under section 3402(e).

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

(3) The basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, monthly, or annually.

case presents is whether reimbursements for noon meals on non-overnight trips constitute "wages" as so defined.

[2, 3] Clearly, these reimbursements are non-deductible income to the employees. In *United States* v. *Correll,* 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537 (1967), the Supreme Court upheld the ruling of the Commissioner (*see, e.g.,* Treas.Reg. § 1.162—17(b)(3)(ii)) that expenses incurred for meals on business trips are deductible only if the trip requires sleep or rest (i. e., and overnight stay. Thus, these reimbursements made for meals on a non-overnight trip are non-deductible income. *Wilson* v. *United States,* 412 F.2d 694 (1st Cir. 1969) (reimbursement for "mid-shift" meal of state trooper, given if the trooper was more than 10 miles from home barracks, held non-deductible income). However, as the government concedes, not all payments constituting income to an employee fall into the category of remuneration for employee services or "wages."

The Supreme Court although not having interpreted this particular section, on at least two occasions has given broad definition to that which constitutes remuneration for employee services. In *Commissioner* v. *LoBue,* 351 U.S. 243, 247, 76 S.Ct. 800, 803, 100 L.Ed. 1142 (1956), the Court wrote:

> When assets are transferred by an employer to an employee to secure better services they are plainly compensation. . . . LoBue received a very substantial economic and financial benefit from his employer prompted by the employer's desire to get better work from him. This is "compensation for personal service" within the meaning of § 22(a).

And in *Social Security Board* v. *Nierotko,* 327 U.S. 358, 365-66, 66 S.Ct. 637, 641, 90 L.Ed. 718 (1946), the Court wrote:

> We think that "service" . . . means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer.

These statements lead us to agree with the view taken by the Second Circuit in *Educational Fund of the Electrical Industry* v. *United States,* 426 F.2d 1053 (2d Cir. 1970). In that case, the question presented was whether $140 paid to electricians in lieu of wages for successfully attending a one-week course at a school established by the union constituted "wages" for withholding purposes. The court held that it did.

> The $140 payments to those who attended the school represented part of the benefit package which was negotiated as part of the wage structure under the collective bargaining agreement in effect between the employers and the union as representative of the electrical workers. The payments ultimately derived from the employers and represented a portion of the agreed upon remuneration for services performed by the employees within the intent of Section 3401(a), just as do payments from pension and vacation funds.

Id., at 1056. This expansive definition of "wages" seems appropriate and harmonizes well with the underlying purposes of the withholding tax system to collect income at its source and to prevent unexpected burdensome tax liabilities come April 15.[2]

---

[2] This view accords well with the legislative history of a similar provision, the definition of "wages" under the social security tax system, 26 U.S.C. § 3121, a definition held to have "the same essential meaning" as that for withholding. *Royster Co.* v. *United States,* 479 F.2d 387, 390 (4th Cir. 1973) The House Report on the initial Social Security Bill, H.R. 7260, 74th Cong., 1st Sess., stated:

> Wages include not only the cash payments made to the employee for work done, but also compensation for services in any other form, such as room, board, etc.

Having found this view appropriate, the opinion of the Fourth Circuit in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973), appears unpersuasive. The court in *Royster* held that payments to salesmen to reimburse them for the cost of their noon meals while in their sales territory did not constitute "wages" for withholding purposes. The government concedes, as it must, that *Royster* is not meaningfully distinguishable from the present case. The *Royster* court took a narrow view of the meaning of "remuneration for services" holding that because the salesmen "performed no services while eating, directly or indirectly," the reimbursement for the meal was not remuneration for services. *Id.*, at 391.

Remuneration for services cannot be viewed this narrowly. The employment relationship is a two-sided bargain, with the employee's services being given for a total package of remuneration, including salary, pension, paid vacation time and other remuneration such as reimbursed lunches. Clearly, in the present case, the employer had no obligation to pay for employee lunches. And certainly, the employee gains by the payment; otherwise, the employee would have to pay for lunch himself. It cannot be doubted that the lunch reimbursements are part of a total package of remuneration designed to attract and hold good employees to the company. As such, they must

---

[2] (Continued)

H.R.Rep. No. 615, 74th Cong., 1st Sess., p. 32 (1939—2 Cumm.Bull. 600, 606). The Senate Report contained similar language:

> The term "wages" is defined to mean all remuneration for employment, including the cash value of all remuneration paid in any other medium than cash. *That is, in addition to money payments, it includes payments in kind, rent, food, lodging, etc.*

S.Rep. No. 628, 74th Cong., 1st Sess., p. 49 (1939—2 Cumm. Bull. 611, 623) (emphasis supplied).

be considered "wages" under 26 U.S.C. § 3401(a) for withholding tax purposes.[3]

Since the noon meal reimbursements at issue in this case are "wages," the employer is liable for withholding tax on them. Thus, the assessment of the District Director against the company was proper. The judgment of the district court is reversed.

Reversed.

---

[3] The company agrees that whatever these reimbursements are classified as, they are still excludable under Treas. Reg. § 31.3401(a)-1(b)(2) concerning traveling expenses. The regulation provides in relevant part:

> Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding.

However, to be travel expenses, the employee must be on travel status; that is, he must be on an overnight trip. *United States* v. *Correll*, 389 U.S. 299, 88 S.Ct. 445, 19 L.Ed.2d 537 (1967). Here the employees were not traveling overnight, and thus, the reimbursements were not travel expenses. Nor were the reimbursements necessary business expenses, for an employee's lunch without more, is not an "ordinary and necessary expense . . . incurred in the business of the employer."

Opinion by Judge Sprecher

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

August 17, 1976

Before
Hon. THOMAS E. FAIRCHILD, *Chief Judge*
Hon. LUTHER M. SWYGERT, *Circuit Judge*
Hon. ROBERT A. SPRECHER, *Circuit Judge*

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

No. 76-1277 vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Illinois.
Civil No. 4920
HARLINGTON WOOD, JR., *Judge*

This cause came on to be heard on the transcript of the record from the United States District Court for the Southern District of Illinois and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, REVERSED, with costs, in accordance with the opinion of this Court filed this date.

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

September 2, 1976

Before
Hon. ROBERT A. SPRECHER, *Circuit Judge*
Hon. .....
Hon. .....

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

No. 76-1277 vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Illinois.
Civil No. 4920
HARLINGTON WOOD, JR., *Judge*

ORDER

The opinion in this case, decided August 17, 1976, is amended to reflect the action taken prior to its issuance by the court *in banc.*

It Is Ordered that an asterisk be added on page 1 of the slip opinion at the end of "Decided August 17, 1976," and that a footnote be added at the bottom of page 1 as follows:

> * This opinion has been circulated among all judges of this court in regular active service. Judges Tone and Wood not participating, no active judge favored a rehearing *in banc* on the question raised by the conflict of this opinion with that of the Fourth Circuit in *Royster* v. *United States,* 479 F.2d 387 (1973).

UNITED STATES COURT OF APPEALS
For the Seventh Circuit
Chicago, Illinois 60604

November 4, 1976

Before

Hon. THOMAS E. FAIRCHILD, *Chief Judge*
Hon. LUTHER M. SWYGERT, *Circuit Judge*
Hon. ROBERT A. SPRECHER, *Circuit Judge*

CENTRAL ILLINOIS PUBLIC SERVICE CO.,
Plaintiff-Appellee,

No. 76-1277 vs.

UNITED STATES OF AMERICA,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of Illinois.

No. 4920

HARLINGTON WOOD, JR., *Judge*

On consideration of the petition for rehearing filed in the above-entitled cause, all of the members of the panel having voted to deny a rehearing,

IT IS ORDERED that the petition for rehearing in the above-entitled cause be, and the same is hereby, DENIED.

SUPREME COURT OF THE UNITED STATES

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

v.

UNITED STATES

Order Allowing Certiorari. Filed May 2, 1977

The petition herein for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit is granted. The case is set for oral argument in tandem with No. 76-1095, Commissioner of Internal Revenue v. Kowalski.

Supreme Court, U. S.
FILED
APR 15 1977
MICHAEL RODAK, JR., CLERK

No. 76-1058

In the Supreme Court of the United States

OCTOBER TERM, 1976

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

WADE H. MCCREE, JR.,
Solicitor General,
Department of Justice,
Washington, D.C. 20530.

In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES

The question presented in this federal income tax case is whether amounts paid by petitioner to reimburse its employees for their noon meal expense incurred on non-overnight travel constituted "wages" within the meaning of Section 3401(a) of the Internal Revenue Code of 1954 (26 U.S.C.), from which income taxes are required to be withheld under Section 3402 of the Code.

Petitioner is a public utility which supplies electricity and natural gas to an extensive area of downstate Illinois. Its employees are often required to make day trips away from their home base during normal business hours.[1]

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[1]At times, petitioner's employees also are away from their home base overnight on business. Those trips are not at issue (see Pet. App. B 11a, n. 3).

When petitioner's employees engage in such non-overnight travel, petitioner reimburses them for amounts theoretically expended for their noonday meal up to certain fixed limits (Pet. App. B 7a).

During 1963, union employees and operating employees of the Western Division (petitioner's only non-unionized division) received a flat rate of $1.40 per noonday meal. This amount is provided for in the union's collective bargaining agreement with petitioner. The full $1.40 could be, and often was, claimed regardless of the amount the employee actually spent on lunch. In some cases, the employee claimed the reimbursement even when he brought his lunch from home. Salaried employees, on the other hand, were reimbursed for their actual meal expense up to $25.00 (Pet. App. B 7a).

During 1963, petitioner paid its employees $139,936.12 as reimbursement for such noonday meals but did not withhold income tax from that amount (Pet. App. B 7a). On audit, the Internal Revenue Service determined that petitioner should have withheld and paid over $36,615.72 from the amounts paid to its employees as meal reimbursements because such amounts constituted "wages" under Section 3401(a) of the Code (*ibid.*).

In this refund suit brought by petitioner in the United States District Court for the Southern District of Illinois, the district court held that the meal payments were not "wages" and that petitioner was not required to withhold income taxes from them (Pet. App. A 1a-4a). The court of appeals unanimously reversed (Pet. App. B 5a-12a). In its view, "the lunch reimbursements are part of a total package of remuneration designed to attract and hold good employees to the company. As such, they must be considered 'wages' under 26 U.S.C. §3401(a) for withholding tax purposes" (Pet. App. B 11a).

As the court of appeals acknowledged (Pet. App. B 11a) and petitioner argues (Pet. 4), its decision holding that payments to employees for meals constitute "wages" under Section 3401(a) conflicts with *Royster Company* v. *United States*, 479 F. 2d 387 (C.A. 4). There, the court held that amounts paid to salesmen to reimburse them for the cost of meals consumed in non-overnight travel were not "wages" subject to withholding because "they got the free lunch whether they made any sales that day or not * * * [and] * * * performed no services during lunch hour" (479 F. 2d at 391-392). But "wages" cannot be defined so narrowly. Section 31.3401(a)-1(a) of the Treasury Regulations on Employment Taxes (26 C.F.R.) defines "wages" as "all remuneration for services performed by an employee for his employer * * *." Here, as in *Royster*, the lunch reimbursements are part of the employee's total remuneration for his services in the same way that vacation pay constitutes "wages."

We are advised by the Internal Revenue Service that the question whether such meal payments are "wages" has substantial administrative importance. There are 295 cases presently pending administratively with approximately $10,350,000 of revenue at stake. Moreover, it is believed that even larger amounts of revenue are involved because many recipients of such payments do not report them as income if they do not appear on their W-2 forms as wages paid by their employers.

Because of the conflict and the importance of the issue,[2] we do not oppose the granting of certiorari with

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[2]A related question is presently before the Court in *Kowalski* v. *Commissioner*, 544 F. 2d 686 (C.A. 3), certiorari granted, March 28, 1977, No. 76-1095. The issue in that case is whether cash meal allowances paid to state police troopers are includable in "gross income" under Section 61(a) or otherwise excludable under Section 119. We

respect to the first question presented in the petition.[3]

Respectfully submitted.

WADE H. MCCREE, JR.,
Solicitor General.

APRIL 1977.

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are serving a copy of this memorandum upon counsel for the respondent in *Kowalski* and upon counsel for the respondent in *United States* v. *Smith*, No. 76-1243, petition for a writ of certiorari pending, which presents only the Section 119 issue.

[3]Petitioner presents a second question whether the Commissioner may "retroactively" impose the obligation to withhold taxes from payments "subsequently" determined to be "wages." There is, however, no basis for review of this question. The Commissioner is free to determine deficiencies in taxes for all open years regardless of the taxpayer's belief in the correctness of its position. Moreover, given the broad regulatory definition of "wages," petitioner had no reason to believe that the lunch payments were not subject to withholding. Indeed, none of the cases cited by petitioner (Pet. 7) involves the question whether meal payments are "wages." We therefore oppose the petition with respect to this second question.

Supreme Court, U. S.
FILED
APR 26 1977
MICHAEL RODAK, JR., CLERK

No. 76-1058

In the

Supreme Court of the United States

OCTOBER TERM, 1976

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY MEMORANDUM FOR THE PETITIONER

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IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1976

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

---

REPLY MEMORANDUM FOR THE PETITIONER

Central Illinois Public Service Company presents two questions in its petition for a writ of certiorari. The United States, through the Solicitor General, does not oppose the granting of certiorari with respect to the first question because of the conflict between circuits and the importance of the issue (Memo. 3).

The Solicitor General relegates his contention that there is no basis for review of petitioner's second question[1] to a footnote (Memo. 4 at n.3). The Solicitor General asserts

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[1] *I.e.*, whether withholding tax obligations may be retroactively imposed on an employer as a matter of law . . . as to payments which subsequently may be deemed to be wages.

that "petitioner had no reason to believe that the lunch payments[2] were not subject to withholding," stating that, "none of the cases cited by petitioner (Pet. 7) involves the question whether meal payments are 'wages' ". This statement is misleading; in fact, petitioner's cases demonstrate that in 1963 noon meal reimbursements were not even considered "income," much less "wages" subject to withholding.

If withholding employers may be retroactively subjected to liability in all open years for failing to predict future judicial interpretations of the tax laws, the consequences will far outweigh the $10,350,000 which the Solicitor General states is at stake in pending cases. Because the issue of retroactivity is so interwoven with the first issue, certiorari should be granted with respect to both questions.

Respectfully submitted,

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[2] [Petitioner's footnote] The Government's memorandum contains an argumentative characterization of the facts which is misleading in light of the district court's findings.

Supreme Court, U. S.
FILED
JUL 5 1977
MICHAEL RODAK, JR., CLERK

No. 76-1058

In the Supreme Court of the United States

OCTOBER TERM, 1976

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

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In the Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (App. 14–18) are reported at 405 F. Supp. 748 (S.D. Ill. 1975). The opinion of the court of appeals (App. 20–27) is reported at 540 F.2d 300 (7th Cir. 1976).

JURISDICTION

The judgment of the court of appeals (App. 28) was entered on August 17, 1976. A timely petition for rehearing was denied on November 4, 1976 (App. 30). The petition for a writ of certiorari was filed on February 1, 1977, and certiorari was granted on May 2, 1977 (App. 31). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Sections 3401 and 3402 of the Internal Revenue Code of 1954 require an employer to withhold federal income taxes only on a payment of "wages." "Wages" are defined in the statute to mean "remuneration . . . for services performed." The questions presented are:

(1) Whether virtually all payments deemed to arise out of, or be attributable to, the employment relationship, such as reimbursements of legitimate noon meal expenses incurred by employees when traveling on required trips, not involving an overnight stay, for the business of their employer, constitute "wages" for withholding tax purposes.

(2) Whether withholding tax obligations may be imposed retroactively on an employer as a matter of law, as the decision below in effect held, if payments subsequently are deemed to be "wages."

STATUTES AND REGULATIONS INVOLVED

The relevant portions of Sections 3401(a), 3402(a) and 3403 of the Internal Revenue Code of 1954 (26 U.S.C.) and of Treasury Regulations, Section 31.3401(a)-1 (26 C.F.R.), are set forth in the Appendix, *infra*, pp. A-1 *et seq.*

STATEMENT

1. The Company[1] is a public utility engaged in the generation, transmission, distribution and sale of electric energy and the distribution and sale of natural gas in Illinois. In accordance with its long-standing policy, the Company reimburses its employees for legitimate expenses of transportation, meals and lodging incurred in required trips for the Company's business. The Company follows the same policy and reimburses on the same basis for overnight trips as for

[1]Petitioner is hereinafter referred to as the Company.

trips where the employee returns before time to sleep (App. 16, 22; Transcript 24–29, 37, 46).

An employee traveling for the Company is required to make an accounting of his expenditures on a Company form and submit the form to a supervisor for approval before reimbursement is made by the Company. In accordance with Treasury regulations, receipts also are required if expenditures exceed $25 (App. 16; Transcript 28, 44).

Reimbursements to unionized employees and operating employees of the Company's western division (a non-unionized division of the Company) for noon meal expenses incurred while traveling for the Company were in an amount not to exceed $1.40 in 1963, the year in question, regardless of the cost of the meal. The amount was based on the union's collective bargaining agreement with the Company. All other employees were reimbursed for the actual cost of meals while traveling if the amounts were reasonable (App. 16; Transcript 29–30).

Depending on the individual and the circumstances, the $1.40 rate was sometimes in excess of the actual lunch cost but very often it was insufficient to cover the cost. Many of these employees were men engaged in open-air labor. On rare occasions when the convenience of the Company required it, the employees on Company travel brought their lunch from home and were entitled to the $1.40 reimbursement. Many of the employees ate lunch at home when they were not traveling on the business of the Company (App. 16; Transcript 94, 110, 113, 116–17, 124, 128, 135, 140–41, 143).

The accounts of employees entitled to receive reimbursement for actual costs expended were carefully reviewed, were subject to question ($2.50 was considered questionable by

trial date prices) and would be disallowed if they were determined not to be reasonable (Transcript 64–66).

The Company's reimbursement policy was based on serving its business interest. The amount of the meal reimbursements was unrelated to the employee's specific job title, the nature of his work, his rate of pay or the value of his service to the Company (App. 17).

During 1963, the Company paid federal income withholding taxes of $1,966,489.87. On audit, the Internal Revenue Service determined that the Company should have withheld an additional $25,188.50 on account of reimbursements paid to employees for noon meal expenses incurred by them while traveling on nonovernight trips for the business of the Company. None of the other travel expense reimbursements made by the Company to its employees in 1963 was asserted to be "wages" subject to withholding (App. 8, 12, 15, 16; Transcript 46).

2. The district court held that the meal reimbursements were not "wages" for withholding tax purposes, favorably citing the Fourth Circuit's views expressed in *Royster Co.* v. *United States*, 479 F.2d 387 (1973) (App. 14–18). The district court observed that to accept the government's view of the reimbursements as "wages" would require "a departure from the realities of business life and a vigorous stretching of the statute . . ." (App. 17). The district court noted that the decision of this Court in *United States* v. *Correll*, 389 U.S. 299 (1967), denying an employee an income tax deduction for meal expenses incurred on nonovernight trips, does not automatically require withholding by employers on reimbursements of such expenses.

The court of appeals reversed (App. 20–27). In holding that the reimbursements constituted "wages," the court in

effect equated "wages" with "income." The court's "expansive" definition of "wages" would include within such term virtually every item attributable to the employment relationship.

SUMMARY OF ARGUMENT

I

This case focuses upon the income tax withholding provisions of the Internal Revenue Code of 1954 wherein "wages" is narrowly defined as "remuneration . . . for services performed." Section 3401(a). The expansive definition substituted by the court of appeals below and urged by the government would include within "wages" virtually every item somehow attributable to the employment relationship. To so expand the definition, however, is to ignore applicable judicial precedent and administrative practice, including the government's own rulings, and effectively to rewrite the statutory provisions.

Legislative history which can be traced back over a half century demonstrates the intent of Congress to confine the scope of employers' withholding obligations. "[S]implicity and ease of administration" (S. Rep. No. 1631, 77th Cong., 2d Sess. 165, *reprinted in* 1942-2 Cum. Bull. 504, 626) provided the underpinnings of the withholding system at its inception in 1942 as well as today. The government and the court below would not only overlook Congressional intent but also the explicit language of long-standing Treasury regulation §31.3401(a)-1(b)(2), which provides that "[a]mounts paid—either as advancements or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred . . . in the business of the employer are not wages and are not subject to withholding."

The failure of the court below to abide by the language of the regulation is astonishing considering its recognition that the reimbursed amounts in this case represented legitimate

travel expenses incurred by employees on the business of the Company (App. 22).

Both the court of appeals below and the government erroneously rely upon income tax authorities to support their all-inclusive view of "wages." "Income" cases cannot be bootstrapped into support for an expansive view of "wages". Congress, the government and the courts have recognized the fundamental distinction between "wages" and "income," namely that "[t]he term 'wages' has a much narrower meaning than the term income, because wages are merely one form of income." *Humble Pipe Line Co.* v. *United States*, 442 F.2d 1353, 1356 (Ct. Cl. 1971). Indeed, in a case "not meaningfully distinguishable from the present case" (App. 26), the Fourth Circuit in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973), rejected an attempt by the government to equate "wages" and "income," stating that: "Wages are merely one form of income. The government's position might well render nugatory any distinction between the two." 479 F.2d at 390.

Judicial precedent, administrative practice and the applicable Treasury regulations under Section 3401 long have recognized that noncompensatory payments to employees made in furtherance of the employer's business do not fall within the category of "wages." Even the government acknowledges this principle (*see* Brief for Petitioner at 25, *Commissioner* v. *Kowalski*, No. 76-1095). The substantial noncompensatory business reasons for the Company's reimbursement policy are unmistakably indicated by the facts of this case. Indeed, both courts below acknowledged that the reimbursements were for legitimate travel expenses incurred on the business of the Company (App. 16, 22).

The court of appeals below premised its expansion of the definition of "wages" upon the erroneous assumption that such an expansion would further the underlying purpose of

the withholding system. In fact, nothing could be further from the truth. A viable withholding system requires specific and simple guidelines. Now the government, with the aid of the decision of the court below, would substitute confusion for the avowed objectives of simplicity and administrative ease. Not only would the decision of the court of appeals below place nearly every employer, including the government, in violation of the withholding provisions, but it would jeopardize the future of the entire withholding system.

II

It is an abuse of discretion to impose retroactively upon employers an expansion of the income tax withholding system. Congress has always permitted employers a grace period to adjust to new withholding obligations and has considered such a practice to be "a matter of equity and custom." S. Rep. No. 66, 95th Cong., 1st Sess. 85-87. Here, however, the government would ignore the Congressional practice and in so doing convert the employer into a guarantor of its employees' income taxes.

Such a conscription of the employer has been criticized by the courts (*see Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362, 1369-70 (Ct. Cl. 1971)), and Congress has cautioned that such action creates havoc in the withholding system. Not only would the government in this case place a never-intended burden on employers, but would do so retroactively. This grates against fundamental fairness and, as even the Internal Revenue Service has recognized, inflicts a harsh result. *See* IRS News Release IR-1724, [1977] Stand. Fed. Tax. Rep. (CCH) ¶6630; IRM MT 4600-21 (5/1/74) (Official Use Only): Technical Guidelines for Disposition of Employment Tax Cases.

It cannot be disputed that it was reasonable for the Company in this case to believe that the rembursements for

admittedly legitimate travel expenses paid in 1963 were not "wages." Indeed, the language of Treasury regulation §31-3401(a)-1(b)(2) specifically confirms such a belief. Fourteen years ago neither the Company, nor any other employer in the country, could be expected to foresee a withholding requirement on such travel reimbursements. The government, in effect, stated as much to the court below (*see* Reply Brief of Appellant at p. 15). In 1963, not one regulation, revenue ruling or judicial decision required withholding on any travel expense reimbursements.

ARGUMENT

I

MEAL REIMBURSEMENTS NECESSITATED BY A NONCOMPENSATORY BUSINESS REASON OF AN EMPLOYER DO NOT CONSTITUTE WAGES FOR FEDERAL WITHHOLDING TAX PURPOSES

The breadth of the term "wages" possesses enormous significance to every employer in the United States because an employer's obligation to withhold federal income taxes is based on the meaning of "wages." If the definition of wages changes, so does the obligation of every employer. At stake in this case is an attempt by the government to make a fundamental revision of employers' withholding obligations. Relying on income tax authorities to support its position, the government has argued that virtually every payment arising out of the employment relationship constitutes "wages," upon which an employer must withhold. The government in seeking to expand the definition of "wages" would rewrite the statute, the regulations, the government's own rulings and a plethora of decided cases.

It must be emphasized that in the present case the Court is not dealing with the concept of "income" as it has developed for federal income tax purposes. Instead, the

Court is asked to focus upon Sections 3401(a) and 3402 of the Internal Revenue Code of 1954 ("the Code"), which, by their express terms, require withholding only on "wages," *i.e.*, "remuneration ... for services performed." As observed by Mr. Justice Frankfurter in *Estate of Rogers* v. *Commissioner*, 320 U.S. 410, 413 (1943), "the right answer usually depends on putting the right question." The right question in this case is not whether the payments were "income" to the employee under Section 61 of the Code but is the much narrower question of whether the payments constitute "wages" for withholding tax purposes.

Specifically, this Court must decide whether certain meal expense reimbursements paid by an employer to employees traveling on nonovernight business trips for the employer are "wages" subject to withholding. The district court below found (App. 14 *et seq.*) that the reimbursements were made by the Company for legitimate business reasons unrelated to compensating its employees and therefore were not "remuneration ... for services performed." The court of appeals below, while acknowledging that the cost of meals represented legitimate travel expenses, reversed (App. 20 *et seq.*) and held, in effect, that the Company's substantial noncompensatory business reasons for the reimbursement arrangement were irrelevant to its withholding obligations. In doing so the court of appeals abandoned the statutory definition of the term "wages," as well as over thirty years of applicable judicial and administrative precedent.

A. THE TERM "WAGES" IS NARROWER THAN THE TERM "INCOME" AND DOES NOT INCLUDE REIMBURSEMENTS FOR LEGITIMATE TRAVEL EXPENSES INCURRED ON BEHALF OF THE EMPLOYER

An employer is required by Section 3402 of the Code to withhold federal income taxes only upon "wages." Section 3401(a) of the Code defines "wages":

> For purposes of this chapter, the term "wages" means all *remuneration ... for services performed* by an employee

> for his employer, including the cash value of all remuneration paid in any medium other than cash. . . . (emphasis supplied)

The legislative history of the income tax withholding system establishes an intentionally narrow and precise scope to employers' obligations through the limitation of withholding to "wages."

The first income tax law following the adoption of the Sixteenth Amendment—the Tariff of 1913—contained a short-lived attempt to collect all income taxes at the source through a catch-all withholding provision:

> All persons . . . having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits and income of another person, exceeding $3,000 for any taxable year, . . . are hereby authorized and required to deduct and withhold from such annual gains, profits and income such sum as will be sufficient to pay the normal tax imposed thereon by this section. . . .[2]

The Revenue Act of 1917 repealed this "collection at the source" provision.[3]

When the present income tax withholding system was conceived in 1942,[4] Congress elected not to return to the all-in-

[2]c.16, §2E, 38 Stat. 114 (1913).

[3]Congress replaced the withholding provision with the ancestor of the present "information at the source" provisions found in Section 6041 *et seq.* of the Code. (*See* Appendix, *infra*, A-1). This substitution was made at the request of the Secretary of the Treasury, who told Congress that collections had been disappointing, and that "excessive and erroneous withholding at the source" had caused great administrative expense in adjusting claims for refund. 55 Cong. Rec. 5967 (1917). *See also* [1917] Treasury Dept. Rep. on the Finances 666–67.

[4]The origin of the present income tax withholding provisions, Section 3401 *et seq.* of the Code, is found in the "Victory Tax"

(footnote continued next page)

clusive provision of the Tariff of 1913. While the House proposal would have included withholding on dividends and bond interest as well as "wages," the Senate version, ultimately adopted in conference, confined the obligation to wages "in the interest of simplicity and ease of administration."[5] Committee reports state that wages meant remuneration only "*if* paid for services performed by an employee for his employer" (emphasis supplied).[6] This language also appears in the regulations.[7]

Current Treasury regulations first issued in 1943—at the inception of the present withholding system—demonstrate that payments made by an employer for its own noncompensatory business purposes are not "wages" subject to with-

provisions of the Revenue Act of 1942, c. 619, §172, 56 Stat. 798 (1942) (repealed by the Individual Income Tax Act of 1944) which was followed by the Current Tax Payments Act of 1943, c. 120, §2(a), 57 Stat. 126 (1943).

[5]S. Rep. No. 1631, 77th Cong., 2d Sess. 165, *reprinted in* 1942–2 Cum. Bull. 504, 626. Attempts to expand withholding to include interest and dividends were again defeated in 1962 and 1976. *See* S. Rep. No. 1881, 87th Cong., 2d Sess. *reprinted in* [1962] U.S. Code. Cong. & Admin. News 3297, 3422–23; Conf. Rep. No. 2508, 87th Cong., 2d Sess., *reprinted in* [1962] U.S. Code Cong. & Adm. News 3732, 3762–63; Amendment No. 1910 to H.R. 10612, 94th Cong., 2d Sess. (1976), defeated in the Senate on June 30, 1976, debate *reprinted in Oversight Hearings into the Operations of the IRS (Income Information Document Matching Program)*: Hearing before the Commerce, Consumer, and Monetary Affairs Subcomm. of the House Comm. on Government Operations, 94th Cong., 2d Sess. 140–78 (1976).

[6]H.R. Rep. No. 2333, 77th Cong., 1st Sess. 126, *reprinted in* 1942–2 Cum. Bull. 372, 465; S. Rep. No. 1631, 77th Cong., 2d Sess. 166, *reprinted in* 1942–2 Cum. Bull. 504, 626; H.R. Rep. No. 401, 78th Cong., 1st Sess. 22, *reprinted in* 1943 Cum. Bull. 1283, 1299, S. Rep. No. 221, 78th Cong., 1st Sess. 17, *reprinted in* 1943 Cum. Bull. 1314, 1327; H.R. Rep. No. 510, 78th Cong., 1st Sess. 2, *reprinted in* 1943 Cum. Bull. 1351, 1352.

[7]Current Treas. Reg. §31.3401(a)-1(a)(2).

holding. Treas. Reg. §31.3401(a)-1(b)(2)[8] provides in pertinent part:

> Traveling and other expenses. Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding.

Despite the fact that courts have long recognized that contemporaneous administrative regulations must be accorded great weight in interpreting a statute,[9] the court of appeals below sought to dispose of this long-standing regulation in a footnote (App. 27 n.3). Without disputing the district court's finding that the employees were traveling on the Company's business, and in fact so confirming in its own summary of the facts (App. 22), the court stated that the regulation did not apply because the employees were not on overnight trips and therefore were not in travel status for purposes of the regulation. The court relied upon this Court's decision in *United States* v. *Correll*, 389 U.S. 299 (1967), which did not even consider the withholding provisions.

[8]Originally promulgated in Section 404.14 of T. D. 5277, 1943 Cum. Bull. 927, 941 (June 28, 1943). *See also* Treas. Reg. §31.3401(a)-1(b)(10), promulgated in Section 404.15 of T.D. 5277, which provides that facilities and privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases) offered by the employer as a means of promoting the health, good will, contentment, or efficiency of its employees are not "wages."

[9]The value to the courts of contemporaneous regulations is founded upon the view that:

> The first administrative interpretation of a provision as it appears in a new act often expresses the general understanding of the times or the actual understanding of those who played an important part when the statute was drafted.

Augustus v. *Commissioner*, 118 F.2d 38, 43 (6th Cir. 1941). *See also Edwards's Lessee* v. *Darby*, 25 U.S. 126, 129, 12 Wheat. 206, 210 (1827); *National Lead Co.* v. *United States*, 252 U.S. 140, 145–46 (1920).

This Court in *Correll*, for reasons of administrative convenience, held that the phrase "away from home" in Section 162(a)(2) of the Code limits employees to an income tax deduction for certain travel expenses only if they are incurred on overnight trips. Nothing in this Court's decision in *Correll* suggests or supports the lower court's conclusion that the disallowance of the income tax deduction could convert an item which is not a "wage" into one which is.

Treasury Regulation §31.3401(a)-1(b)(2), in excluding reimbursements of travel and other expenses from "wages," is significant in the absence from it of the "away from home" language of Section 162(a)(2). The "overnight" concept was never included in the withholding regulations. The absence of the "away from home" language is hardly an oversight. The government argued to the court of appeals below that the Internal Revenue Service had "consistently since 1940" taken the position that travel expenses on nonovernight trips were not deductible by employees under Section 162(a)(2) of the Code (Reply Brief at 17). It is curious, indeed, that the government, if it thought the overnight concept had application to withholding, did not see fit to incorporate it in the withholding regulations which it drafted only a few years later in 1943. We believe that the government in promulgating the regulations under the withholding tax provision did not deem the allowance or disallowance of a deduction to employees for travel expenses as having any bearing on the withholding requirements of the employers because reimbursements for travel expenses were never considered to fall within the limited term "wages."[10]

[10]Reimbursements of traveling expenses made to employees, whether for transportation, meals or lodging, long have been considered "income" to the employee under Section 61 of the Code and its predecessors, but never before have been considered "wages" because such payments are not "for services performed." The allowance or disallowance to the employee of an offsetting income tax deduction for such amounts does not, and cannot, change the basic nature of the payment.

It is evident that the attempt of the court of appeals to use this Court's holding in *United States* v. *Correll*, 389 U.S. 299 (1967), to support its conclusion that the reimbursements involved in this case were "wages" cannot stand. This Court in *Correll* neither considered nor decided the withholding tax treatment of the payments to employees, nor was it asked to do so. Moreover, legislative history and the Treasury regulations preclude such a bootstrapping of *Correll*.

Congress, the Internal Revenue Service and the courts repeatedly have recognized in the past that a change in the income tax treatment of an item does not thereby convert an otherwise non-wage item into a "wage" for federal withholding tax purposes. In 1964, when Congress added Section 79 to the Code (making group term life insurance purchased by employers taxable to employees), it expressly rejected a proposal to include this benefit in "wages."[11] In 1969, when Congress brought employer reimbursements for certain moving expenses within the definition of gross income, it deliberately drafted the language of Section 82 of the Code so that it unambiguously informed employers that withholding is required on such reimbursements.[12]

The administrative practice of the Internal Revenue Service, as embodied in many of its revenue rulings, has long recognized the fundamental distinction between the income tax treatment with respect to an employee and the withholding requirements of an employer. In many instances, the Service has stated that cash payments from an employer to an

[11] *See* S. Rep. No. 830, 88th Cong., 2d Sess. *reprinted in* [1964] U.S. Code. Cong. & Adm. News 1868, 1878–79; H.R. Rep. No. 1149, 88th Cong., 2d Sess. *reprinted in* [1964] U.S. Code. Cong. & Adm. News 1940, 1959.

[12] *See* S. Rep. No. 552, 91st Cong., 1st Sess. *reprinted in* [1969] U.S. Code. Cong. & Adm. News 2027, 2141; H.R. Rep. No. 413, 91st Cong., 1st Sess. *reprinted in* [1969] U.S. Code. Cong. & Adm. News 1645, 1723.

employee would not be subject to withholding despite the fact that the payments would be includable in the employee's gross income. For example, in Rev. Rul. 55–520, 1955–2 Cum. Bull. 393, the Service held that an amount paid to an individual as a compromise settlement for the cancellation of the unexpired portion of the individual's employment contract did not represent wages upon which the employer was obliged to withhold. Such amount was, however, to be included in the individual's gross income for federal income tax purposes. Rev. Rul. 56–249, 1956–1 Cum. Bull. 488, dealt with trust payments to an employee from an employer's supplemental unemployment benefit plan. The Service held that the payments did not constitute wages but were includable in the employee's gross income. Similar rulings holding that not every income item arising out of the employment relationship is a "wage" subject to withholding appear in Rev. Rul. 58–301, 1958–1 Cum. Bull. 23 (cancellation of employment contract), Rev. Rul. 58–145, 1958–1 Cum. Bull. 360 (athlete's bonus for signing a professional contract) and Rev. Rul. 59–227, 1959–2 Cum. Bull. 13 (lump sum payment to employee for relinquishment of seniority rights and acceptance of new position), modified and superseded prospectively by Rev. Rul. 75-44, 1975-1 Cum. Bull. 15.

The decision of the court below represents a marked departure from the decisions of other courts which have consistently rejected attempts to equate "income" with "wages." For example, in *Peoples Life Insurance Co.* v. *United States*, 373 F.2d 924 (Ct. Cl. 1967), the court rejected the government's reliance upon "income" cases in applying the withholding provisions:

> [The income cases] were not concerned with the different problem of what, in a proceeding involving only the employer, constitutes "wages" or "remuneration" within the meaning of the withholding tax provisions. There is no necessary correlation between what constitutes

> "wages" or "remuneration" paid by an employer within the meaning of the employment or withholding tax sections and what constitutes "income" to the employee within the meaning of the "gross income" sections.

373 F.2d at 932 (footnotes omitted). *Accord, Acacia Mutual Life Insurance Co.* v. *United States*, 272 F.Supp. 188 (D. Md. 1967).

The distinction between wages and income (and the impropriety of utilizing income cases to resolve issues concerning wages) was again emphasized by the companion *Humble* cases, *Humble Pipe Line Co.* v. *United States*, 442 F.2d 1353 (Ct. Cl. 1971), and *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362 (Ct. Cl. 1971). In both cases, relocation expense reimbursements to employees were held not to be wages. The *Humble Pipe Line* court noted that "[t]he term 'wages' has a much narrower meaning than the term income, because wages are merely one form of income." 442 F.2d at 1356.

And in *Stubbs, Overbeck & Associates, Inc.* v. *United States*, 445 F.2d 1142 (5th Cir. 1971), the Fifth Circuit considered whether the income tax withholding provisions applied to per diem payments which were made as a living allowance to employees located at a job site remote from the employer's regular place of business. In holding that the payments did not represent "wages," the court remarked:

> [W]e are not concerned with what constitutes taxable income to the employee. . . . Whether or not payments are taxable to, or deductible by, the employee is immaterial with regard to whether they are subject to withholding by the employer.

445 F.2d at 1149.

The Fourth Circuit in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973), considered whether meal reimbursements

to employee-salesmen traveling in the sales territory of the employer constituted "wages." In the district court in *Royster*, the government abandoned its position that the income tax provisions of the Code were *in pari materia* with the withholding provisions. *See* 479 F.2d at 388. However, the government attempted in the Fourth Circuit indirectly to resurrect its discarded argument by insisting that wages be construed as encompassing everything "attributable to the employment relationship." 479 F.2d at 390. This new argument, as the Fourth Circuit emphasized, was merely another attempt—in different guise—to equate "wages" with "income." The court refused to make the equation, indicating that "wages" is a narrower term than income. "Wages are merely one form of income. The government's position might well render nugatory any distinction between the two." *Id.* The Fourth Circuit, properly noting that the "right question" was whether the payments were made to the employees as remuneration for services performed, concluded that the meal expense reimbursements did not represent "wages."

The court of appeals below acknowledged that its decision was in conflict with *Royster*, commenting "[t]he government concedes, as it must, that *Royster* is not meaningfully distinguishable from the present case" (App. 26). While purporting to acknowledge that not all payments constituting "income" to employees fall into the category of "wages," the court below nevertheless immediately proceeded to cite with favor this Court's discussion of the broad definition of income in *Commissioner* v. *LoBue*, 351 U.S. 243 (1956). In *LoBue*, this Court held that an employee realized "gross income" within the meaning of the predecessor of Section 61 of the Code at the time he exercised stock options granted to him in order to confer a "proprietary interest" in the company for which he worked. Thus, the Seventh Circuit failed at the outset to state the "right question" or to appreciate the distinction between "income" and "wages."

The court of appeals below cited only two "wage" cases in support of its conclusion that an "expansive" definition of employers' withholding obligations was appropriate: *Social Security Board* v. *Nierotko*, 327 U.S. 358 (1946), and *Educational Fund of Electrical Industry* v. *United States*, 426 F.2d 1053 (2d Cir. 1970) (App. 24–25). However, in both *Nierotko* and *Educational Fund* the facts were totally disimilar to the present case in that the payments at issue were made in lieu of and as a substitute for actual pay. In *Nierotko*, for example, this Court held that "back pay" awarded by the National Labor Relations Board to a wrongfully discharged employee constituted "wages" for purposes of federal old age benefits under the Social Security Act.[13] The Court's opinion contains broad dicta concerning the meaning of "wages" for purposes of FICA tax withholding. 327 U.S. at 365–66. The actual basis for the decision of the Court is most clearly explained by Mr. Justice Frankfurter in his concurring opinion:

> [A]n employer must pay wages although in violation of law, he has subjected his employee to enforced idleness. Since such compensation is in fact paid as wages, it is a plain disregard of the law for the Social Security Board not to include such payments among the employees' wages.

327 U.S. at 371.

[13]"Wages" is defined in the Social Security Act as "remuneration for employment" and "employment" is defined as "any service . . . performed . . . by an employee for his employer." 42 U.S.C. §409; 26 U.S.C. §3121. Because Social Security is sometimes regarded as a system of employee benefits rather than as a tax, "wages" has often been interpreted differently for purposes of F.I.C.A. and F.U.T.A. withholding than for purposes of income tax withholding. *See* IRM MT 4600-21 (5/1/74) (Official Use Only): Technical Guidelines for Disposition of Employment Tax Cases. *But cf. Royster Co.* v. *United States*, 479 F.2d 387, 390 (4th Cir. 1973). No issue is presented here that FICA and FUTA withholding were required.

Similarly, the *Educational Fund* case involved payments made as a substitute for actual pay. In that case, electricians were allowed one week off, without pay, by their employers to attend school. Upon successful completion of their courses, however, the electricians were given $140 "as partial compensation for lost wages and expenses." 426 F.2d at 1055. The Second Circuit rejected the contention that the $140 payments were an expense allowance, finding that "[t]he payments bore no relation to any expenses actually incurred by those electricians who attended the school." 426 F.2d at 1056–57.

In sharp contrast, both courts below characterized the payments in this case as reimbursements for legitimate travel expenses. This case does not involve payments made in lieu of wages; *Nierotko* and *Educational Fund* are simply irrelevant.

B. UNDER THE WITHHOLDING TAX PROVISIONS THE TERM "WAGES" INCLUDES ONLY REMUNERATION FOR SERVICES PERFORMED

Section 3401(a) of the Code confines the definition of "wages" to "remuneration . . . for services performed." The theme underlying the Treasury regulations and the court decisions considering the term "wages" is that payments made for a noncompensatory business reason of the employer—*i.e.*, in furtherance of the employer's business—cannot be characterized as remuneration for services performed, which is the crucial determination under the withholding provisions.[14]

[14]Even the government does not deny the significance of an employer's noncompensatory business reason. Indeed, it acknowledges that in certain circumstances "cash allowances do not 'represent compensation' to the employee because they are in furtherance of the employer's business." (Brief for Petitioner at 25, *Commissioner* v. *Kowalski*, No. 76-1095 (Sup. Ct., filed Feb. 7, 1977), *cert. granted*, 97 S. Ct. 1578 (1977)). Further, the noncompensatory business reason of the employer need not be the sole factor prompting the furnishing of the item to the employee. *See* Treas. Reg. §1.119-1(a)(2).

In each of the decisions discussed above at pp. 16-18, as in the instant case, the payments or reimbursements were determined without regard to, and in no way were related to, an employee's wage rate, job status or value of his services to the employer. The reimbursements were not intended to be for, and were not measured by, services performed. As the court stated in *Humble Pipe Line*:

> Thus, the amounts which the plaintiff expended in defraying the moving costs of its employees were, "from plaintiff's point of view as an employer, expenditures incurred to advance its own wholly legitimate and bona fide business purposes." Peoples Life Insurance Co. v. United States, 373 F.2d 924, 929, 179 Ct. Cl. 318, 327 (1967). It follows that, in paying out amounts to defray its employees' moving costs, the plaintiff was not compensating or otherwise rewarding the employees for services rendered by them.

442 F.2d 1353, 1356-57 (Ct. Cl. 1971). *See also* the recent opinion in *Allstate Insurance Co.* v. *United States*, 530 F.2d 378, 380, 383 (Ct. Cl. 1976).

The facts of this case demonstrate conclusively that the reimbursements to employees of the Company cannot be characterized as remuneration for services performed. The Company reimbursed its employees for their legitimate expenses, including noon meal expenses, when they were traveling on behalf of the Company (App. 16, 22). These payments were in the form of reimbursements, not pre-paid unrestricted cash allowances, and were subject to careful scrutiny by appropriate supervisory Company personnel. The accounting for expenses, which each employee was required to submit in order to receive the reimbursement, was done on forms supplied by the Company for this purpose. These forms had to be approved in writing by the employee's supervisor (App. 16; Transcript 32–37). At all times the reimbursements were treated on the Company's books as travel expenses and were never placed in the salary account or described as a salary

item or an addition to an employee's base salary (Transcript 21, 43). The amount of the reimbursement was specifically identified as travel expenses upon payment to the employee (Plaintiff's [district court] Exhibit 11; Transcript 40). Both courts below found that the expenses were incurred in legitimate travel on behalf of the Company (App. 16, 22).

The amount of reimbursement was not a function of the rank of the employee, or related in any way to his specific job title, nature of work, rate of pay or value of service to the Company (App. 17). The reimbursement was not for any service performed by the employee; the employee was not on duty during the noon hour, nor was he subject to call more than during other non-working hours (App. 17).

The Company's established reimbursement policy was for noncompensatory business purposes. The reimbursement policy was instituted for the economic benefit of the Company and the payments were limited to legitimate transportation, meal and lodging expenses of employees traveling on the business of the Company. The policy avoided the cost of transporting the employees back to Company headquarters and the attendant loss of work-hours. (App. 17) The reimbursed amount and the Company's policy did not vary according to whether the travel was overnight or nonovernight (Transcript 24–29). To contend that a policy established for noncompensatory business reasons of the Company in furtherance of its business results in remuneration for services performed—and somehow with respect to the noon meal expense portion only—requires "a departure from the realities of business life and a vigorous stretching" of the statutory meaning of "wages" (App. 17).

C. AN "EXPANSIVE" DEFINITION OF WAGES IS INCONSISTENT WITH THE EXISTING WITHHOLDING SYSTEM

The decision of the court of appeals below apparently was based on the court's own concept of the withholding system

without regard to the statute, Congressional intent or the all-important consideration of establishing a system that will operate simply and fairly. The court stated: "This expansive definition of 'wages' seems appropriate and harmonizes well with the underlying purposes of the withholding tax system to collect income at its source and to prevent unexpected burdensome tax liabilities come April 15" (App. 25, footnote omitted).

As shown above (pp. 10-12), Congress elected to establish an intentionally narrow and precise scope to employers' withholding obligations by requiring withholding only on "wages" because it served "the interest of simplicity and ease of administration." The court of appeals improperly undertook to substitute its judgment for that of Congress. As this Court has recognized:

> [i]n the interpretation of statutues levying taxes it is the established rule not to extend their provisions, by implication, beyond the clear impact of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out.

Gould v. *Gould*, 245 U.S. 151, 153 (1917). *Accord, United States* v. *Merriam*, 263 U.S. 179, 187–88 (1923); *Allstate Insurance Co.* v. *United States*, 530 F.2d 378 (Ct. Cl. 1976).

The court of appeals unwittingly has opened a pandora's box which could disrupt the operation of the withholding system. As observed by the Treasury Department recently in discussing withholding on fringe benefits: "If we should attempt to include in the withholding base every economic benefit enjoyed by great numbers of employees, the operation of the system would be seriously jeopardized."[15]

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[15]Office of the Ass't Sec'y for Tax Policy, Summary and Discussion Draft of Proposed Regulations on Fringe Benefits, Daily Tax Rep. (BNA), No. 172, at J-9 (September 4, 1975).

The present withholding system works well because employers' obligations intentionally are simple and unambiguous. The difficulties of an indiscriminate extension of the withholding system are far-reaching, as Congress already has recognized. Employers cannot be forced to speculate at their own risk as to items on which withholding is required.

The court of appeals below obviously failed to appreciate the confusion it would introduce, and the repercussions of its decision, when it extended the definition of "wages" to encompass virtually every payment or benefit attributable to, or arising out of, the employment relationship. It has told employers, in effect, that they no longer can rely on the Treasury regulations, which have remained unchanged since promulgation in 1943, excluding travel expense reimbursements from the definition of wages.[16] It apparently also is telling employers that they have withholding obligations on certain non-cash items (which may or not be susceptible of valuation) which the Internal Revenue Service itself has not yet determined are taxable, much less "wages."[17]

The impact of the court of appeals' decision is to place almost every employer in violation of the withholding tax provisions, including the government.[18] This result will be

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[16]Treas. Reg. §31.3401(a)-1(b)(2), discussed, *supra*, pp. 12-14.

[17]*E.g.*, such so-called "fringe benefits" as free parking, health services, use of government or company automobile, cafeterias, gymnasiums, etc. Commissioner Kurtz of the Internal Revenue Service has recently asked his Advisory Group for its views as to the taxability of such "fringe benefits." *See* Daily Tax Rep. (BNA), No. 110, at J-9 (June 7, 1977). The previous administration was unable to articulate which of these benefits should be taxed. *See* Treasury Department Statement, December 17, 1976, on Withdrawal of Discussion Draft of Proposed Regulations on Taxation of Fringe Benefits, Daily Tax Rep. (BNA) No. 245, at J-9 (Dec. 20, 1976).

[18]In Tax Management Memorandum, TMM 75–03, at p. 8 (February 3, 1975), it is noted:

(footnote continued next page)

repeated in the future if employers are required to guess at the meaning of an "expansive" judicial definition to perform their duties under the law. Congress has shown that it is well aware that a viable withholding system requires specific and simple guidelines. The system was never intended either to operate as the court of appeals below assumed would be "appropriate" or to be extended as the government has proposed.[19]

> . . . Tax Management has been advised that some employees of the Federal Government receive a partial *per diem* allowance to cover comparable travel expenses [to those in *Royster Co.* v. *United States*, 479 F.2d 387 (4th Cir. 1973)] in situations where they are not away from home overnight, and that the Federal government does not withhold tax on such amounts.

Further, as the government's own announcements show (*see, supra*, note 17 and accompanying text), the government does not treat fringe benefits to its employees as income and, undoubtedly, does not withhold on any such amounts.

[19]The Internal Revenue Service proposed in Rev. Rul. 69–592, 1969–2 Cum. Bull. 193, that withholding be required on travel reimbursements if:

> it is reasonable to believe, under all the facts and circumstances known to the employer at the time of the reimbursement, that the total per diem allowances paid to an employee during the taxable year will exceed the total of his deductible travel expenses incurred while he is traveling away from home on business. . . .

The total lack of any support in law for this position is shown by the fact that the ruling never once uses the word "wages," and never once recognizes the existence of the long-standing Treasury regulations relating to travel expenses. But even accepting the ruling on its face, the proposed test is unworkable. Under this ruling, the government would impose on each employer the obligation of determining the personal tax situation of each of its employees, and predicting the travel for each during the year, in order to ascertain any withholding obligations on travel reimbursements made to them.

II

RETROACTIVE IMPOSITION OF TAX WITHHOLDING OBLIGATIONS ON EMPLOYERS IS AN ABUSE OF DISCRETION

In the thirty-five years in which the modern income tax withholding system has been in operation, Congress has never acted to expand the scope of employers' withholding obligations or to increase the amount required to be withheld without giving employers a grace period to adjust to the new requirements. Congress has granted this relief as "a matter of equity and custom."[20] Moreover, Congress has observed that when the Internal Revenue Service attempts to enforce new withholding requirements retroactively, it "creates havoc" in the payroll tax system (*see, infra*, p. 27).

A. EMPLOYERS ARE NOT OBLIGATED TO BE GUARANTORS OF TAX PAYMENTS LATER DEEMED SUBJECT TO WITHHOLDING

Congress has provided under Sections 3402 and 3501 of the Code that employers must collect federal taxes from "wages" which they owe to their employees and pay over such amounts to the government. The taxes being collected are those of the *employees* and the employers act as mere conduits. While employers may be liable for payment of the tax if they fail to withhold as required, this provision does not elevate the basic function of the employers to something more than collecting agents.

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[20]S. Rep. No. 66, 95th Cong., 1st Sess. 85–87, referring to action taken in 1977 by Congress to relieve employers of liability for failure to deduct and withhold taxes in 1976 from certain amounts such as sick pay which, but for the enactment of the Tax Reform Act of 1976 late in 1976, would not have been subject to withholding in 1976. *See* Tax Reduction and Simplification Act of 1977, Pub. L. No. 95–30, §404, 91 Stat. 126 (1977).

Because employers collect the tax from payments *to be made*, they are entitled to know in advance with clarity the nature and scope of their withholding obligations. If employers make payment without withholding because the law or administrative practice does not then require withholding, a later change in the rules, if applied retroactively, necessarily results in making employers absolute guarantors for the collection of their employees' taxes.[21]

The Court of Claims in *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362 (1971), has criticized the government for attempting to hold an employer as a guarantor in a similar case involving reimbursements paid to employees for certain moving expenses. The court said:

> Thus, in 1961, Humble had no reason to suspect that when, for its own benefit, it reimbursed the moving expenses of its *existing* employees, it was paying them wages "for services performed" as defined in section 3402. Under these circumstances, Humble should not be penalized and used "as a device . . . to determine the basic tax liability" of its employees who are not even parties to this case. (emphasis in original)

442 F.2d at 1369-70 (quoting from *Peoples Life Insurance Co.* v. *United States*, 373 F.2d 924, 933 (Ct. Cl. 1967)).[22]

[21]Section 3402(d) of the Code provides that if a nonwithholding employer can show that its employees paid the tax which should have been withheld, the employer is not liable for the tax. However, this is usually impossible as a practical matter.

[22]This passage from *Humble Oil* is dicta because the Court of Claims had already rejected the attempt by the Service to characterize such reimbursements as "wages." *See Allstate Insurance Co.* v. *United States*, 530 F.2d 378 (Ct. Cl. 1976). Because the government has consistently failed in its attempts to obtain judicial expansion of the definition of "wages," whether such a changed definition should be applied retroactively is an issue of first impression in this case. The issue was extensively briefed in the court of appeals below (*see* Brief for the Appellee at 22-26; Reply Brief at 15-19), but that court ignored the problem in its opinion, even though the government acknowledged that employers had not been on notice as to the need to withhold. (*See, infra*, note 29).

Reacting to a similar pattern of litigation, Congress has recently told the Internal Revenue Service not to apply new administrative positions retroactively against employers who failed to withhold on payments made to persons whom they reasonably thought were "independent contractors," and therefore not subject to withholding.[23] The Conference Committee for the Tax Reform Act of 1976, Pub. L. 94-455, observed:

> Most of our income taxes, almost all of our social security taxes, and all of our unemployment taxes come in through the payroll tax system. *We cannot afford to have this system disrupted. The IRS creates havoc when it comes in for all past years if it changes its formal position as to typical contractual arrangements in an industry*, or if the IRS suddenly begins to treat as an employment relationship the sort of situation which for a long time it has accepted on an industry-wide basis as an independent contractor arrangement. . . . (emphasis supplied)[24]

The problem caused by retroactive enforcement of new withholding requirements is the same, whether such requirements are established through manipulation of the term "independent contractor" or of the term "wages."[25] Employers who complied with existing law at the time for withholding are held liable, though they are without fault.

[23]S. Rep. No. 938, 94th Cong., 2d Sess. 604; S. Rep. No. 1236, 94th Cong., 2d Sess. 489, *reprinted in* 1976-3 Cum. Bull. 807, 897. Congress requested the Joint Committee on Taxation to study problems regarding the definition of "independent contractors" as contrasted with "employees."

[24]122 Cong. Rec. S12,496 (Daily ed. July 26, 1976) (adopting remarks of Senator Long), incorporated in S. Rep. No. 1236, 94th Cong., 2d Sess. 489, *reprinted in* 1976–3 Cum. Bull. 807, 893.

[25]The Internal Revenue Service is presently planning a campaign to tax "fringe benefits" which have not, as a matter of administrative policy, been taxed before (*see, supra*, note 17). If these benefits are taxed, the government may attempt to require employers to withhold on such benefits, even though they are not in the form of

(footnote continued on next page)

Congress has given the Secretary of the Treasury the authority to "prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect." Section 7805(b) of the Code. This Court has ruled that under this section the Internal Revenue Service has "a large measure of discretion" in determining when to apply changes in the law retroactively. *Dixon* v. *United States*, 381 U.S. 68, 79–80 (1965). However, this Court's decision in *Dixon* has never been thought to provide the government with unlimited authority to apply new positions retroactively or to insulate the use of its discretion from judicial review. The Internal Revenue Service may not use this power arbitrarily to favor one taxpayer over another. *International Business Machines* v. *United States*, 343 F.2d 914 (Ct. Cl. 1965). Nor may it depart abruptly from established administrative positions without an adequate explanation. *Atchison, T. & S. F. Ry. Co.* v. *Wichita Bd. of Trade*, 412 U.S. 800, 807–08 (1973); *Sirbo Holdings, Inc.* v. *Commissioner*, 476 F.2d 981, 987 (2d Cir. 1973) (Friendly, C.J.).

Discretion implies prudence, restraint and fairness. It also implies that agents in collecting the revenues, such as employers, be adequately informed of their obligations in advance. Retroactive enforcement of new rules by the government shifts the burden of the tax from the employees upon whom Congress imposed it, to the employer.

The Internal Revenue Service has recognized from time to time that withholding should not be imposed retroactively where employers had no reasonable basis to believe that

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cash payments or readily susceptible of valuation. Retroactive enforcement of any such withholding requirements for all open years would create chaos in the American business community. Yet what difference is there between the position of the Company with respect to legitimate travel expenses incurred in 1963 and the position of most employers today with respect to fringe benefits provided their employees?

withholding was or would be required at the time payments were made. For example, in Rev. Rul. 76-453, 1976-2 Cum. Bull. 86, the Service announced that it intended to reverse an earlier position and hold that reimbursements for certain traveling expenses to temporary jobsites (for example, travel from an employee's residence directly to a client's office) would constitute nondeductible income to employees, citing the decision of the Tax Court in *Turner* v. *Commissioner*, 56 T.C. 27 (1971). The ruling also announced that such reimbursements would be considered to be "wages" subject to FICA, FUTA, and income tax withholding as of the effective date of the ruling. The effective date of the ruling continues to be postponed, however, "[t]o allow employers additional time to advise their employees of the effect of the ruling and to make necessary changes in their accounting and business procedures."[26]

In like manner, with respect to the payments of "supper money" to employees who work overtime, the Internal Revenue Service instructed its agents in 1974 in the Internal Revenue Agent's Manual[27] that O.D. 514, 2 Cum. Bull. 90 (1920), holding such payments not to be income to the employees because paid for the convenience of the employer, should be viewed as precluding retroactive assessments of withholding taxes. The Manual states: "Pending publication of regulations clarifying the Service's position, examining officers are instructed not to raise the issue of the applicability of income tax withholding with respect to such payments."[28]

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[26]IRS News Release IR-1724, [1977] 9 Stand. Fed. Tax. Rep. (CCH) ¶6630; Announcement 77-113, 1977-28 I.R.B. at ___. *See also* Rev. Rul. 75-44, 1975-1 Cum. Bull. 15; Rev. Rul. 64-40, 1964-1 Cum. Bull. 68; Rev. Rul. 62-150, 1962-2 Cum. Bull. 213.

[27]IRM MT 4600-21 (5/1/74) (Official Use Only): Technical Guidelines for Disposition of Employment Tax Cases.

[28]*Id.*

B. IT WAS REASONABLE FOR THE COMPANY TO BELIEVE WHEN IT PAID THE MEAL REIMBURSEMENTS THAT THEY WERE NOT "WAGES" SUBJECT TO WITHHOLDING

In 1963, not one regulation, revenue ruling or judicial decision required withholding on any travel expense reimbursements. In fact, the regulations specifically provided, as they do now, that "[a]mounts paid—either as advancements or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred . . . in the business of the employer are not wages and are not subject to withholding." Treas. Reg. §31.3401(a)-1(b)(2), *supra*, pp. 12-13.

It is not disputed that the reimbursements paid in this case were expenses incurred by employees while on legitimate travel for the business of the Company (App. 16, 22). In these circumstances, no employer reading the regulations in 1963 would reasonably suspect that a withholding requirement existed.[29]

The government contended in the court below that an old ruling, I.T. 3395, 1940-2 Cum. Bull. 64 (which pre-dated the withholding regulations adopted in 1943), should have put the Company on notice that withholding was required. I.T. 3395 allowed an income tax deduction to locomotive engineers and other railroad trainmen for their expenses of room and meals on trips for the business of their employer during which they stopped for rest. Thus, this ruling involved an income tax deduction to employees and not a withholding tax

[29]The government is well aware that employers heretofore have not been apprised of the need to withhold. In its Reply Brief at p. 15, the government stated to the court of appeals below:

> . . . we urge that the Court not consider this issue [*i.e.* retroactivity] until it has passed upon the primary question which is of considerable importance as a precedent and the resolution of which is essential so that the instant taxpayer, and other employers making similar payments, will be on notice as to the need for withholding.

question. Apparently, the government now views this ruling as a veiled announcement of its "overnight" rule (*see, supra*, pp. 13-14). Significantly, the government itself did not deem it appropriate to reflect this ruling in its withholding tax regulations adopted shortly after the ruling was issued (*see, supra*, p. 13); it is hardly reasonable to expect that employers should have done so.

In 1963, when the reimbursement payments at issue were made, judicial decisions supported a reasonable belief that an offsetting deduction would be available to employees receiving reimbursements in connection with non-overnight business trips. In *Hanson* v. *Commissioner*, 298 F.2d 391 (8th Cir. 1962), the Eighth Circuit rejected the government's position that meal expenses are only deductible under Section 162 when incurred in connection with a trip involving an overnight stay. Prior to the 1962 decision in *Hanson*, the overnight rule had been rejected by the Fifth Circuit in *Williams* v. *Patterson*, 286 F.2d 333 (5th Cir. 1961), and by the First Circuit and a Minnesota district court in cases involving non-meal travel expenses. *Chandler* v. *Commissioner*, 226 F.2d 467 (1st Cir. 1955), and *Scott* v. *Kelm*, 110 F. Supp. 819 (D. Minn. 1953).

In decisions issued after 1963, the overnight rule continued to be rejected by the courts. In *Ahrens* v. *United States*, 264 F. Supp. 518 (S.D. Ill. 1967), in a case involving one of the Company's employees, the court held that noon meal reimbursements of the exact type here in issue gave rise to an employee deduction under Section 162 of the Internal Revenue Code. *See also Correll* v. *United States*, 369 F.2d 86 (6th Cir. 1966), *rev'd*, 389 US. 299 (1967). It was not until this Court's decision in *United States* v. *Correll*, 389 U.S. 299 (1967), rendered in December, 1967 (more than four years after the meal reimbursements at issue were paid by the Company), a case decided principally on the basis of convenience in the administration of the tax laws, that meal payments in con-

nection with a trip not involving an overnight stop were held not to be deductible by employees under Section 162 of the Code.

None of the courts in these cases including this Court in *Correll* considered the withholding tax question or was asked to do so. Until the decision of the court of appeals below, no court ever had held travel reimbursements to be "wages."

The first published pronouncement by the Internal Revenue Service regarding withholding on travel expenses did not come until 1969 in Rev. Rul. 69-592, 1969-2 Cum. Bull. 193. Apparently, this ruling was precipitated by this Court's holding in *United States* v. *Correll*, 389 U.S. 299 (1967). The ruling suggests a possible requirement of withholding on reimbursed travel expenses which exceed travel deductions but it avoids any mention of the statutory requirement that a payment must be a "wage" to be subject to withholding. Thus, the ruling tacitly appears to recognize that a requirement of withholding on travel expense reimbursements is not supported by the statutory definition of "wages." Significantly, the ruling also recognizes that employers reasonably could not be expected to have foreseen a withholding requirement on travel expense reimbursements. The ruling states:

> *Accordingly, unless it is reasonable to believe, under all the facts and circumstances known to the employer at the time of the reimbursement,* that the total per diem allowances paid to an employee during the taxable year will exceed the total of his deductible travel expenses incurred while he is traveling away from home on business, *no withholding of income tax is required with respect to per diem allowances paid to cover his meal expenses on trips that do not require him to stop for sleep or rest.* (emphasis supplied)

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be reversed. Petitioner also requests a remand to the district court for the award of attorney's fees pursuant to 42 U.S.C. §1988.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C. 1958 ed.):

SEC. 3401. DEFINITIONS.

(a) *Wages.*

For purposes of this chapter, the term "wages" means all remuneration . . . for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash . . . .

• • • •

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) *Requirement of withholding.*

Every employer making payment of wages shall deduct and withhold upon such wages (except as otherwise provided in this section) a tax determined in accordance with the following tables . . . .

• • • •

SEC. 3403. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of any such payment.

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SEC. 6041. INFORMATION AT SOURCE.

(a) *Payments of $600 or more.*

All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income . . .

of $600 or more in any taxable year, . . . shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

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SEC. 7805. RULES AND REGULATIONS

(a) *Authorization*

. . . [T]he Secretary shall prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue.

(b) *Retroactivity of regulations or rulings.*

The Secretary may prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

• • • •

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§31.3401(a)-1 *Wages*

(a) In general.

(1) the term "wages" means all remuneration for services performed by an employee for his employer unless specifically exempted under section 3401(a) or excepted under section 3402(e).

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

• • • •

(b) *Certain specific items*

• • • •

(2) *Traveling and other expenses.*

Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. Traveling and other reimbursed expenses must be identified either by making a separate payment or by specifically indicating the separate amounts where both wages and expense allowances are combined in a single payment.

• • • •

(10) *Facilities or privileges.*

Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as wages subject to withholding if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees.

• • • •

(T. D. 6259, 1957-2 Cum. Bull. 645)

Supreme Court, U. S.
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No. 76-1058

In the Supreme Court of the United States

OCTOBER TERM, 1977

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE UNITED STATES

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BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The opinion of the district court (Pet. App. A 1a–4a) is reported at 405 F. Supp. 748. The opinion of the court of appeals (Pet. App. B 5a–12a) is reported at 540 F.2d 300.

JURISDICTION

The judgment of the court of appeals (Pet. App. C 13a) was entered on August 17, 1976. On November 4, 1976, the court of appeals denied a petition for rehearing filed by petitioner (A. 30). The petition for a writ of certiorari was filed on February 1, 1977,

and was granted on May 2, 1977 (A. 31). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

Section 3401(a) of the Internal Revenue Code of 1954 defines "wages" for purposes of the withholding tax provisions to include "all remuneration * * * for services performed by an employee for his employer."

The questions presented are:

1. Whether cash payments made by an employer to reimburse his employees for the cost of noon meals consumed in the course of non-overnight travel are "wages" subject to withholding taxes.

2. Whether, if such payments are "wages," the Commissioner's assessment of unpaid withholding taxes against petitioner for an open year under the statute of limitations was a proper exercise of his statutory authority to enforce the internal revenue laws.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 61, 3401, 3402 and 3403 of the Internal Revenue Code of 1954, as amended (26 U.S.C. (1958 ed.)) and of the Treasury Regulations on Employment Taxes (1954 Code), Sections 31.3121(a)–1 and 31.3401(a)–1(a) (26 C.F.R.), are set forth in the Appendix, *infra,* pp. 1A–3A.

STATEMENT

Petitioner is a public utility engaged in the generation, transmission, distribution, and sale of electric energy and the distribution and sale of natural gas in Illinois. In order to cover the geographical area

which it serves, it is often necessary for petitioner to dispatch its employees on travel assignments, on both day trips during normal working hours and overnight travel (Pet. App. B 7a).

Petitioner maintains a policy of reimbursing its employees for expenses incurred for transportation, meals and lodging while traveling on company business. In the case of the non-overnight travel at issue in this case, petitioner reimburses its employees for the cost of their noon meals consumed away from their normal duty station. The amount of the reimbursement varied with the status of the employee (Pet. App. B 7a).

During 1963, the taxable year at issue, petitioner reimbursed its union employees and its operating employees of the only non-unionized division for noon meals consumed away from their normal duty station. The reimbursement was not to exceed $1.40 per noon meal.[1] This amount was fixed in the union's collective bargaining agreement with petitioner (Pltf. Ex. 2, pp. 23–24; Pltf. Ex. 3, pp. 22–23). Other more senior salaried employees were reimbursed for their actual expenses up to $25 per meal (Pet. App. B 7a; Tr. 29–30, 44–46).[2]

The employee entitled to the $1.40 per meal payment claimed the allowance on a company form that he submitted to his supervisor for approval (Tr. 32;

[1] In 1960, the noon meal reimbursement was $1.30. In 1961, the union negotiated an increase to $1.40 (Tr. 93).

[2] "Tr." refers to the trial transcript.

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Pltf. Exs. 6, 7, 8). In many cases, the employee claimed and received the full amount whether or not he actually incurred out-of-pocket lunch expenses in that amount—*e.g.*, when he brought his lunch from home (Pet. App. B 7a; Tr. 58–59).

During 1963, petitioner paid its employees $139,936.12 in reimbursements for noon meals consumed while away from their normal duty stations on non-overnight trips. These amounts were included in the employees' pay checks. However, petitioner did not withhold any taxes from these payments (Pet. App. A 2a; Pet. App. B 7a; Tr. 63). On audit, the Commissioner of Internal Revenue determined that the meal reimbursements paid by petitioner to its employees were "wages" subject to withholding pursuant to Sections 3401 and 3402 of the Internal Revenue Code of 1954. The Commissioner accordingly assessed additional withholding taxes of $36,615.72, which petitioner paid (Pet. App. B 7a).

In this refund suit brought by petitioner in the United States District Court for the Southern District of Illinois, the district court held that the meal payments were not wages subject to withholding (Pet. App. A 1a–4a). The district court cited the fact that the "[employee] renders no service to the company during his lunch" because "[he] was off duty during this time. His time was his own" (Pet. App. A 4a). In so holding, the district court was persuaded by the similar views expressed in *Royster Co.* v. *United States,* 479 F. 2d 387 (C.A. 4) (Pet. App. A 4a).

The court of appeals unanimously reversed. It held that the meal payments at issue were part of the total benefits paid by petitioner for the services of its employees and therefore were remuneration for employee services or "wages" subject to withholding (Pet. App. B 5a–12a). Accordingly, the court of appeals rejected the decision of the Fourth Circuit in *Royster Co.* v. *United States, supra,* which held that similar payments were not wages because the employees "performed no services while eating, directly or indirectly" (479 F. 2d at 391; Pet. App. B 11a). The court of appeals stated: "Remuneration for services cannot be viewed this narrowly. The employment relationship is a two-sided bargain, with the employee's services being given for a total package of remuneration, including salary, pension, paid vacation time and other remuneration such as reimbursed lunches" (Pet. App. B 11a).

SUMMARY OF ARGUMENT

I.

1. Petitioner's cash payments made to reimburse its employees for the cost of noon meals consumed during non-overnight travel are "wages" subject to withholding taxes.

Section 3401(a) of the Internal Revenue Code of 1954 defines "wages" for purposes of the withholding provisions to include "all remuneration * * * for services performed by an employee for his employer, including the cash value of all remuneration paid in

any medium other than cash * * *." This definition of "wages" corresponds to the first category of "gross income" set forth in Section 61(a)(1)—"Compensation for services, including fees, commissions, and similar items" that are paid in the context of an employer-employee relationship.

Petitioner argues that the reimbursements are not "wages" subject to withholding because they are non-compensatory payments made in furtherance of its business. The record, however, fully supports the court of appeals' conclusion that the meal allowances were compensatory. Petitioner required its employees to perform their assigned services at places it determined. In return for those services, the employees became entitled to certain agreed-upon benefits pursuant to the union contract. If an employee worked at his normal duty station, he received his salary; if he were assigned to a more remote location on non-overnight travel, he received both his salary and the meal allowance. Conversely, if the employee performed no services, he would receive neither salary nor the meal allowance.

Hence, there was a direct causal connection between the receipt of the meal allowance and the performance of services. As the court of appeals correctly observed, the meal allowances were "part of a total package of remuneration designed to attract and hold good employees to the company" (Pet. App. B 11a). Accordingly, they were "remuneration * * * for services performed by an employee for his employer" and therefore "wages" under Section 3401(a).

2. The decision below is fully in accord with this Court's longstanding definition of compensation for purposes of the tax statutes. As the Court stated in *Commissioner* v. *Lo Bue*, 351 U.S. 243, 247, "[w]hen assets are transferred by an employer to an employee to secure better services they are plainly compensation. * * * LoBue received a very substantial economic and financial benefit from his employer prompted by the employer's desire to get better work from him. This is 'compensation for personal service' within the meaning of § 22(a) [of the 1939 Code]." Likewise, in *Social Security Board* v. *Nierotko*, 327 U.S. 358, the Court ruled that a payment by an employer to his employee did not have to be tied to the performance of any particular service in order to qualify as "wages" under the comparable definition of the Social Security Act. In so holding, the Court observed "that 'service' as used by Congress in the definitive phrase means not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer" (*id.* at 365–366; footnote omitted).

The meal allowances at issue here are not different from special bonuses, bargain stock options, housing allowances, vacation pay, or reimbursements for personal expenses such as school tuition or income taxes. An employer need not provide such benefits in return for a specific service. To the contrary, he extends them to his employee "to enlist more efficient service," "to secure better services," or because of "the employer's desire to get better work from him."

Commissioner v. *LoBue, supra,* 351 U.S. at 247. For purposes of the tax law, there is accordingly no difference between such benefits and traditional wage or salary payments. They are both taxable "compensation for personal services" under Section 61(a)(1) and "remuneration * * * for services performed by an employee for his employer" under the equivalent definition of "wages" of Section 3401(a).

3. The court of appeals properly concluded that *Royster Co.* v. *United States,* 479 F. 2d 387 (C.A. 4), was wrongly decided. There, the court held that similar payments for noon meals consumed by salesmen engaged in non-overnight travel were not "wages" subject to withholding because the salesmen performed no services while eating. But that rationale cannot be reconciled with this Court's definition of "service" under the analogous social security provisions as including "not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Social Security Board* v. *Nierotko, supra,* 327 U.S. at 365–366 (footnote omitted).

4. Finally, there is no basis for petitioner's argument that the meal allowances fall within the exclusion from wages for "[a]mounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred * * * in the business of the employer * * *." Treasury Regulations, Section 31.3401(a)-1(b)(2). The phrase "ordinary and necessary expenses" is a statutory term of art that refers to deductible business

expenses under Section 162(a) of the Code. But in *United States* v. *Correll,* 389 U.S. 299, the Court held that the cost of meals consumed during non-overnight travel was not a deductible business expense under Section 162(a). Since the employees could not deduct the cost of such meals, the exclusion of the Regulation is inapplicable. The meal allowances are therefore fully includable in the employees' taxable income and are properly subject to withholding taxes.

II.

If the Court holds, in accordance with our submission, that the meal allowances are "wages" subject to withholding, the Commissioner's assessment for 1963 was a proper exercise of his authority to enforce the internal revenue laws. Petitioner argues that it is nevertheless entitled to prevail in this refund suit because it was reasonable for it to believe in 1963 that the meal allowances were not wages and that such belief should override what would otherwise be a valid timely assessment. But the Commissioner's position with respect to the meal allowances is precisely the same as it was in 1963. Then, as now, the Commissioner maintained that the costs of meals consumed during non-overnight travel were non-deductible personal expenses. Indeed, the Commissioner first announced his position in 1940, prior to the enactment of the withholding tax provisions.

Thus, petitioner had ample notice since 1940 that the Commissioner regarded the meal allowances as fully includable in its employees gross income without any deduction or offset. Since the meal allowances did

not qualify as deductible business expenses to the employees, there was no factual or legal basis upon which petitioner could have concluded that its meal allowances were not subject to withholding. The Commissioner's determination should therefore be upheld as a proper exercise of his authority to assess all taxes (Section 6201(a)) within the applicable period of limitations.

ARGUMENT

I.

CASH PAYMENTS MADE BY AN EMPLOYER TO REIMBURSE HIS EMPLOYEES FOR THE COST OF NOON MEALS CONSUMED DURING NON-OVERNIGHT TRAVEL ARE "WAGES" SUBJECT TO WITHHOLDING TAXES

A. INTRODUCTION

This federal income tax case involves the scope of the statutory definition of "wages" from which employers are required to withhold taxes. Since 1942, the withholding tax system has been an integral part of the administration of the internal revenue laws. As a practical matter, Congress recognized that the higher wartime rates made it difficult for persons to pay their tax liabilities at the time they filed their return after the close of the taxable year. By requiring the collection of income taxes at their source, Congress sought to prevent the loss of large amounts of revenue that would not be collected because of the time interval between the receipt of income and the filing of the returns reporting such income. See Revenue Act of 1942, Section 172, 56 Stat. 884; Current Tax Payment Act of 1943, 57 Stat. 126; H.R. Doc. No. 237, 78th

Cong., 1st Sess. 1 (1943); H.R. Rep. No. 268, 78th Cong., 1st Sess. 1-2 (1943).

The current statutory provisions are set forth in Sections 3401–3403 of the Internal Revenue Code of 1954, as amended.[3] Section 3402(a) provides that "[e]very employer making payment of wages shall deduct and withhold upon such wages" a tax determined in accordance with tables prescribed by the Secretary. Section 3403 makes the employer liable for the payment of the tax. This case focuses upon the statutory definition of "wages," the type of income that Congress determined to be subject to the withholding tax.

Section 3401(a) defines "wages" to include "all remuneration (other than fees paid to a public official) for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash * * *." The question presented is whether cash payments made by an employer to reimburse his employees for the cost of noon meals consumed during non-overnight travel are "wages" within the meaning of Section 3401(a).

There is a necessary although not entirely congruent relationship between the statutory concept of "gross income" (Section 61(a) of the Code) and the definition of "wages" at issue in this case. As the enumerated list in Section 61(a) of what constitutes "gross income" shows, the concept encompasses the

[3] The pertinent provisions of the statutes involved are retained in the amendments made by the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520, 1557.

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entire gamut of receipts—compensation for services, interest, rents, royalties, dividends, alimony, pensions, etc. If an item does not fall within the broad category of gross income, it cannot constitute wages subject to withholding taxes.

Conversely, not every item of gross income is wages subject to withholding. The statutory definition limits "wages" to "all remuneration * * * for services performed by an employee for his employer." Accordingly, the essential characteristic of "wages" is that they are compensation for services in the context of the employer-employee relationship.

In determining whether a particular item constitutes "wages," the name by which it is designated is immaterial. "Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer." Treasury Regulations, Section 31.3401(a)–1(a)(2), Appendix, *infra*, p. 3A. The basis upon which remuneration is paid is likewise irrelevant in determining whether it is wages. Wages may be set "on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually." Treasury Regulations, Section 31.3401(a)–1(a)(3), Appendix, *infra*, p. 3A.

These regulatory definitions of "wages" are a more detailed formulation of the first category of "gross income" set forth in Section 61(a)(1)—"Compensation for services, including fees, commissions, and similar items." See also Treasury Regulations on Income Tax, Section 1.61–2(a)(1). Thus, assuming the existence of an employer-employee relationship, the definition of "wages" corresponds to the type of "gross income" described in Section 61(a)(1).

As we have argued in our brief in *Commissioner* v. *Kowalski*, No. 76–1095,[*] employer reimbursements for meals consumed by employees during non-overnight travel are includable in the employees' gross income within the meaning of Section 61(a) and are not otherwise excludable under Section 119. That latter provision excludes from an employee's gross income the value of meals in kind furnished by his employer on the employer's business premises. Since the definition of gross income encompasses all receipts "from whatever source derived" unless specifically exempted by statute and the cash payments to petitioner's employees are not meals in kind furnished on the business premises of the employer, they are includable in the employees' gross income and subject to tax.

Unlike the respondent in *Kowalski*, petitioner does not contend that the cash payments at issue in this case are excludable from gross income or eligible for the special exclusion of Section 119 for meals in kind furnished on the business premises of the employer. Indeed, petitioner acknowledged before the district court that "there's no question that these items are income items" (Tr. 8). Moreover, as this Court held in *United States* v. *Correll*, 389 U.S. 299, petitioner's employees could not deduct the cost of these meals as

[*] We have provided counsel for petitioner with a copy of our brief in *Commissioner* v. *Kowalski*.

a business expense under Section 162 of the Code because they were consumed during non-overnight travel. Thus, the payments at issue in this case are fully includable in the employees' taxable income under Section 63(a).

However, petitioner argues that while the meal payments may be taxable income, they are not "wages" subject to withholding because they are (Br. 6) "noncompensatory payments to employees made in furtherance of [its] business." But petitioner's characterization of the meal payments as "noncompensatory" ignores the fact that the allowances were, as the court of appeals correctly observed, "part of a total package of remuneration designed to attract and hold good employees to the company" (Pet. App. B 11a). As we shall show, petitioner's payment for its employees' lunches, like their salary, vacation pay, or any other benefits arising out of their employment, was "remuneration * * * for services performed" and therefore "wages" within the meaning of Section 3401(a).[5]

B. THE MEAL ALLOWANCES PAID BY PETITIONER TO ITS EMPLOYEES ARE COMPENSATORY "REMUNERATION FOR SERVICES" WITHIN THE MEANING OF SECTION 3401(a)

1. It is undisputed that the meal allowances were paid in the context of the employer-employee rela-

[5] Petitioner's argument that the meal allowances are noncompensatory is essentially identical to the taxpayer's argument in *Commissioner* v. *Kowalski* (No. 76–1095) that such allowances are excludable from "gross income" under Section 61(a). See pp. 28–32 of our brief in *Kowalski*.

tionship and that they were not gifts (cf. Section 102(a); *Commissioner* v. *Jacobson*, 336 U.S. 28, 47–52). Since these payments provided petitioner's employees with a valuable personal benefit, they necessarily fall within the scope of the category of "gross income" described in Section 61(a)(1)—"Compensation for services, including fees, commissions, and similar items." Given the equivalent scope of Sections 61(a)(1) and 3401(a), the meal allowances are likewise "remuneration * * * for services performed by an employee for this employer" within the meaning of that latter provision and therefore "wages."

The record fully supports the court of appeals' conclusion that petitioner's meal allowances were compensatory. Petitioner required its employees to perform their assigned services at places it determined. In exchange for the performance of their services, the employees became entitled to certain agreed-upon benefits pursuant to the union contract. If an employee worked at his normal duty station, he received wages; if the employee were assigned to a more remote location on non-overnight travel, he received both the amounts designated as wages and the meals allowance. Conversely, if the employee performed no services, he would receive neither wages nor the meal allowance.

Hence, there was a direct causal connection between the receipt of the meal allowance and the performance of services. As the Second Circuit observed in holding that an employer's cash payments to its employees for the successful completion of a training course con-

stituted "wages," "[t]he * * * payments * * * represented part of the benefit package which was negotiated as part of the wage structure under the collective bargaining agreement * * *. The payments ultimately derived from the employers and represented a portion of the agreed upon remuneration * * * within the intent of Section 3401(a), just as do payments from pension and vacation funds." *Educational Fund of the Electrical Industry* v. *United States,* 426 F. 2d 1053, 1056 (C.A. 2). Here, too, the meal allowance and its amount were established as a result of bargaining between petitioner and its employees' union. There is accordingly no qualitative difference between the meal allowance and any other element of the employees' compensation.[6]

The meal allowance is therefore comparable to any other type of personal economic benefit that an employer might provide an employee in exchange for his services, such as vacation pay, pension allowances, personal use of a company car, tuition payments for children, and the like. In each of these instances, the employee gains by the benefit, for he would otherwise have to bear the cost of these items himself. Similarly, in this case, if petitioner did not pay for its employees' lunches when they were engaged in non-overnight

[6] Petitioner (Br. 18) would distinguish *Educational Fund of the Electrical Industry* on the ground that the payments there involved were made in lieu of and as a substitute for actual pay. But petitioner can hardly deny that an employer may provide his employees with personal benefits in addition to their basic salary that would also qualify as "wages." The essential point of the decision is that when, as here, such benefits constitute the agreed-upon remuneration, they are "wages" subject to withholding.

travel, they would have had to purchase their own lunch.

The meal allowances were therefore part of the total consideration paid by petitioner in exchange for a person assuming the status of one of its employees. The conclusion is accordingly inescapable that the meal allowances in this case were compensatory "remuneration * * * for services" under Section 3401(a) and therefore subject to withholding taxes.

2. This analysis finds support in the decisions of this Court defining compensation for purposes of the tax statutes. In *Old Colony Trust Co.* v. *Commissioner,* 279 U.S. 716, the Court held employees taxable on the amount of their income taxes paid by their employers. The Court stated that "[t]he taxes were paid upon a valuable consideration, namely, the services rendered by the employee and as part of the compensation therefor" (*id.* at 729) and that "[t]he payment for services, even though entirely voluntary, was nevertheless compensation within the statute" (*id.* at 730).

Likewise, in *Commissioner* v. *LoBue,* 351 U.S. 243, the Court ruled that an employer's transfer of stock to his employee at less than its fair market value resulted in taxable income to the employee. The Tax Court had upheld the taxpayer's contention that there was no taxable income on the ground that one purpose of the employer was to confer a "proprietary interest" and thereby provide the employees with "an incentive to promote the growth of the company * * *" (22 T.C. 440, 445). But since it was undisputed that

the employer's transfer was not a gift, the Court rejected the relevance of the employer's purpose in making the transfer, stating that "it seems impossible to say that it was not compensation" (351 U.S. at 247). As the Court further observed, "[w]hen assets are transferred by an employer to an employee to secure better services they are plainly compensation. * * * LoBue received a very substantial economic and financial benefit from his employer prompted by the employer's desire to get better work from him. This is 'compensation for personal service' within the meaning of § 22(a) [of the 1939 Code]" (*ibid.*). See also *Commissioner* v. *Smith,* 324 U.S. 177, 182.

In *Social Security Board* v. *Nierotko,* 327 U.S. 358, the Court held that a back pay award under the National Labor Relations Act constituted "wages" for purposes of the Social Security Act. Like Section 3401(a), the Social Security Act defined "wages" as "all remuneration for employment" and defined employment as "any service, of whatever nature, performed * * * by an employee for his employer * * *." In support of its contention that a back pay award was not "wages," the Social Security Board contended that the plaintiff did not perform any particular service for the back pay award. But the Court refused to adopt the Board's "limited circumscription of the word 'service'" (*id.* at 365). As the Court stated, "[w]e think that 'service' as used by Congress in this definitive phrase means not only work actually done but the entire employer-employee relationship

for which compensation is paid to the employee by the employer" (id. at 365–366).[7]

Finally, in *Otte* v. *United States,* 419 U.S. 43, 49–50, the Court again rejected the claim that a payment could only fall within the category of "wages" if it were attributable to the performance of a particular service at or near the time of payment. The Court observed that in defining "employer," Section 3401 (d) "twice refers to services that the employee 'performs or performed.' It thus speaks in the past tense as well as the present and thereby plainly reveals that a continuing employment relationship is not a prerequisite for a payment qualification as 'wages.'" Accordingly, if a payment is owing as a result of an employment relationship, it is "wages" as long as it is part of the total of personal benefits that arose out of that relationship.

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[7] Both the Fourth Circuit in *Royster Co.* (479 F. 2d at 390) and the court below (Pet. App. B 10a n. 2) recognized that the term "wages" under the social security tax provisions has "the same essential meaning" as under the income tax withholding statutes. Thus, with respect to the definition of "wages" under the social security provisions, the House Report stated that "[w]ages include not only the cash payments made to the employee for work done, but also compensation for services in any ther form, such as room, board, etc." H.R. Rep. No. 615, 74th Cong., 1st Sess. 32 (1935). See also S. Rep. No. 628, 74th Cong., 1st Sess. 49 (1935).

Under the current social security tax regulations, there is an exclusion from "wages" for "facilities or privileges" provided by an employer to his employees, *e.g.*, entertainment, medical services, or courtesy discounts, if such benefits are of relatively small value. However, the term "facilities or privileges" does not ordinarily include "the value of meals or lodging furnished * * * since generally these items constitute an appreciable part of the total remuneration of such employees." Treasury Regulations, Section 31.3121(a)–1(f), Appendix, *infra*, pp. 2A–3A.

3.a. Petitioner does not deny that it paid the meal allowances in the context of the employer-employee relationship. However, it argues (Br. 6) that while the allowances may be taxable income, they were not "wages" because they were noncompensatory payments made in furtherance of its business and were not paid for the performance of any specific service. In petitioner's view (Br. 21), the fact that its employees were not on duty during their noon meal period renders the meal allowances noncompensatory because they were unrelated to the value of their services or their seniority status.

But petitioner's characterization of the allowance as "noncompensatory" is at odds with the Court's definition of compensation under the tax statutes (see *supra,* pp. 17–19). Moreover, petitioner's contention that the payments at issue were not "wages" because they were unrelated to any employee services is likewise erroneous. As we have pointed out *supra,* pp. 18–19, the Court rejected virtually the identical argument more than 30 years ago in *Social Security Board* v. *Nierotko, supra.* The statutory concept of "wages" is not tied to the performance of any particular service, but includes any personal economic benefit given by an employer to his employee as a result of the employment relationship.

Thus, for example, an employer may provide vacation pay with respect to periods during which the employee performs no services whatsoever. However, it cannot be seriously contended that vacation pay is not "wages" subject to withholding. See *Campbell Sash Works, Inc.* v. *United States,* 217 F. Supp. 74

(N.D. Ohio). The essential point is that vacation pay is a personal economic benefit to the employee arising out of the employment relationship. Like special bonuses, bargain stock options, or reimbursements for personal expenses such as housing costs, school tuition or income taxes, an employer need not provide such benefits for any specific services performed in the past or to be performed in the future. To the contrary, an employer extends these benefits to his employee "to enlist more efficient service," "to secure better services," or because of "the employer's desire to get better work from him." *Commissioner* v. *LoBue, supra,* 351 U.S. at 247.[8] See also *United States* v. *Woodall,* 255 F.2d 370, 372 (C.A. 10), certiorari denied, 358 U.S. 824.

For purposes of the tax law, there is accordingly no difference between such benefits and traditional wage or salary payments. They are both taxable "[c]ompensation for [personal] services" under Section 61(a)(1) and "remuneration * * * for services performed by an employee for his employer" under the equivalent definition of "wages" set forth in Section 3401(a).[9]

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[8] Petitioner seeks to minimize the impact of *LoBue* by characterizing the decision (Br. 17) as a "broad definition of income." But the court below correctly recognized that *LoBue* directly addressed the question of what "constitutes remuneration for employee services" (Pet. App. B 9a). Given the equivalence between Sections 61(a)(1) and 3401(a) in the context of the employer-employee relationship, the Court's decisions with respect to "gross income" in that context are highly instructive in determining the scope of the statutory definition of "wages."

[9] Petitioner argues (Br. 21) that the amounts of the meal allowances were unrelated to the employees' seniority. But the record

b. *Royster Co.* v. *United States*, 479 F. 2d 387 (C.A. 4), upon which petitioner places its principal reliance (Br. 6, 16–18, 24), was therefore wrongly decided, and the court below properly refused to follow it. In *Royster Co.*, the court held that similar payments for noon meals consumed by salesmen engaged in non-overnight travel were not "wages" under Section 3401(a). The court's decision rests upon three grounds: (1) the salesmen were not required to do anything to qualify for the payments other than to eat on the road; (2) the salesmen performed no services while eating; and (3) providing the salesmen with meal allowances enabled the employer to save the mileage costs it would have incurred if the salesmen returned home to eat lunch (see *id.* at 390–391).

The first ground adopts an erroneously narrow view of the meal allowance. Contrary to the Fourth Circuit's assumption, the salesmen did not qualify for the payment simply by eating their noon meal on the road; they were required to be engaged in a sales mission on behalf of their employer that took them away from their home base of employment. Here, too, petitioner's employees were only eligible for the meal allowance if they were in the midst of a non-overnight travel assignment on behalf of petitioner at the time of their noon meal. Hence, there was a direct *quid pro quo* between the employee's performance of services and his eligibility for the meal payment.

shows that the senior non-union employees were reimbursed for their actual meal expenses up to $25 per meal (Pet. App. B 7a; Tr. 29–30, 44–45). At all events, the fact that the amount of the meal allowances was uniform would not necessarily exclude them from the definition of "wages." For example, if an employer provides each of his employees, regardless of rank, with an automobile for his personal use, the value of that privilege would be "wages" subject to withholding.

The second and third grounds are irrelevant to the question whether the meal allowance is "wages." The fact that the employees performed no particular service while eating lunch does not show that the meal payments were not wages. Indeed, this Court's definition of "wages" under the social security statutes refutes the court of appeals' conclusion.

Under those analogous provisions, the Court has defined "service" to include "not only work actually done but the entire employer-employee relationship for which compensation is paid to the employee by the employer." *Social Security Board* v. *Nierotko, supra,* 327 U.S. at 365–366 (footnote omitted) (see *supra,* pp. 18–19). Thus, the employee's temporary respite from his labors during his noon meal hour does not exclude the meal allowance from "wages" under Section 3401(a), any more than his leisure during vacation would exclude vacation pay from "wages" (see pp. 20–21, *supra*). "The decisions of this Court leave no doubt that a man's time may, as a matter of law, be in the service of another though he be inactive. *E.g., Armour & Co.* v. *Wantock,* 323 U.S. 126. This is, practically speaking, the ordinary situation of employment in a 'stand-by' capacity" (327 U.S. at 370–371, Frankfurter, J., concurring).

Finally, the fact that an employer might choose to provide meal allowances and thereby save the mileage costs of his employees' transportation back to their home base does not support the exclusion of the allowances from the definition of "wages." To begin with, such an analysis cannot stand in the face of the Court's admonition that "[t]ax consequences follow what has taken place, not what might have taken place." *Central Tablet Mfg. Co.* v. *United States,* 417 U.S. 673, 690; *Commissioner* v. *National Alfalfa Dehydrating & Milling Co.,* 417 U.S. 134, 148–149, and cases cited therein. Moreover, there is no basis for the Fourth Circuit's assumption in *Royster Co.* that the employer was obliged to pay either for his employees' noon meals or the cost of transporting the employees back to the home office for their lunch period.

To the contrary, the employer could have let the salesmen bear the cost of their own lunches, as employees are required to do in most cases. But once the employer agrees, as petitioner did, to subsidize the cost of his employees' personal meals, the court of appeals correctly concluded that the reimbursements "are part of a total package of remuneration designed to attract and hold good employees to the company. As such, they must be considered 'wages' under 26 U.S.C. § 3401(a) for withholding tax purposes" (Pet. App. B 11a; footnote omitted).

C. THE MEAL ALLOWANCES ARE NOT REIMBURSEMENTS FOR DEDUCTIBLE BUSINESS EXPENSES

1. Petitioner further argues (Br. 12) that the meal allowance are not "wages" because they are reimbursements of travel and other ordinary and necessary business expenses. In support of this contention, petitioner relies upon Treasury Regulations, Section 31.3401(a)–1(b)(2), which provides that "[a]mounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding."

The court of appeals correctly rejected petitioner's attempt to analogize its employees' expenses for meals consumed during non-overnight travel to "traveling or other bona fide ordinary and necessary expenses incurred * * * in the business of the employer" (see Pet. App. B 11a–12a n. 3). The phrase "ordinary and necessary expenses" is a statutory term of art that refers to deductible business expenses under Section 162(a) of the Code. See *Welch* v. *Helvering,* 290 U.S. 111, 113–115. However, Section 262 bars any deduction "for personal, living, or family expenses."

As we have pointed out *supra,* pp. 13–14, in *United States* v. *Correll,* 389 U.S. 299, the Court held that a taxpayer traveling on business may deduct the cost of his meals under Section 162(a)(2) as "traveling expenses" incurred in the pursuit of business "while away from home" only if his trip required him to

stop for sleep or rest. In so ruling, the Court approved the Commissioner's "overnight rule" which was first expressed in a 1940 ruling, I.T. 3395, 1940–2 Cum. Bull. 64. Thus, expenses for meals consumed during non-overnight travel are non-deductible personal expenses under Section 262.

Viewed in the light of the Commissioner's long-standing overnight rule, the employees' noon meal allowances are not reimbursements for deductible business expenses within the meaning of the Regulation so as to exclude them from the statutory definition of "wages." The thrust of the Regulation is to exclude from "wages" only those payments that would be subtracted from the recipient's taxable income by means of an offsetting business expense deduction.[10] Here, however, the employees were not engaged in overnight travel so that the meal payments were not travel expenses.

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[10] The Regulation is therefore consistent with various statutory exclusions from the definition of "wages" for payments that are not subject to income tax (Section 3401(a)(1)—combat pay allowance; Section 3401(a)(8)(A)(ii)—exclusion for income earned abroad), or where at the time of payment it is reasonable to believe that a corresponding deduction would be allowable (Section 3401(a)(15)—moving expense allowance).

Accord: Rev. Rul. 69–592, 1969–2 Cum. Bull. 193 (per diem allowances for meals consumed in non-overnight travel not subject to withholding unless it is reasonable to believe that the total travel allowances paid to an employee will exceed his deductible travel expenses for the taxable year). While petitioner (Br. 24 n. 19) attacks this ruling as "unworkable," an employer surely can estimate whether the reimbursements provided to his employees can reasonably be expected to exceed his actual expenses.

Moreover, the meal allowances were not "ordinary and necessary" business expenses deductible by the employees since the cost of an employee's lunch is not an "ordinary and necessary expense[ ] * * * incurred in the business of the employer" no matter where or in what circumstances the meal is eaten. Since the meal allowances are fully includable in the employees' income and not deductible to any extent, they are properly subject to withholding taxes like any other type of "wages."

2. Once it is recognized that the meal allowances are includable in the employees' gross income and not deductible by them as business expenses, the lower court decisions upon which petitioner relies (Br. 15–16) are distinguishable.[11] For example, the exclusion from "wages" of the value of a trip to a bona fide business convention that was upheld in *Peoples Life Insurance Co.* v. *United States,* 373 F.2d 924 (Ct. Cl.), involved overnight travel on behalf of the employer that would be deductible as a business expense by the employee. The case therefore falls within the exclusion from wages provided by Treasury Regulations, Section 31.3401(a)–1(b)(2), Appendix, *infra,* p. 3A (see 373 F. 2d at 935). Accord: *Acacia Mutual Life Insurance Co.* v. *United States,* 272 F. Supp. 188 (D. Md.). Cf. *Rudolph* v. *United States,* 370 U.S. 269; *Patterson* v. *Thomas,* 289 F.2d 108 (C.A. 5), certiorari denied, 368 U.S. 837.

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[11] The only appellate decision involving the same type of allowance for meals consumed during non-overnight travel is *Royster Co.* v. *United States,* 479 F. 2d 387 (C.A. 4.), which we submit was wrongly decided (see pp. 22–24, *supra*).

In this respect, the value of the convention trip to the employee was akin to any other type of cash advance made by an employer to enable his employee to obtain meals and lodging during overnight travel or to incur such expenses solely for the benefit of his employer. In those circumstances, the employee is entitled to deduct such expenses if the trip is "related primarily to [his] trade or business." See Treasury Regulations, Section 1.162–2(b)(2). Since such payments were not includable in the employees' taxable income, they were held not to be "wages" subject to withholding (see pp. 25–27, *supra*).[12]

Here, however, the meal allowances petitioner provides are not deductible by the employees as business expenses.[13] Hence, petitioner's subsidy of the cost of what is undisputably a nondeductible personal ex-

[12] *Stubbs, Overbeck & Associates, Inc.* v. *United States*, 445 F.2d 1142 (C.A. 5), upon which petitioner relies (Br. 16), is likewise distinguishable. There, the court ruled that an employer's per diem payments to his employees assigned to remote job sites were not "wages" subject to withholding. But the court's decision turned upon the fact that the employee's assignment was away from home overnight, so that his expenses were deductible. The court rejected the Internal Revenue Service's position (Rev. Rul. 59–371, 1959–2, Cum. Bull. 236) that an assignment for more than 12 months lost its character as a temporary job away from home. See *Peurifoy* v. *Commissioner*, 358 U.S. 59.

[13] Thus, the district court's observation (Pet. App. A 3a), that "[a]s a practical matter, [the meal allowance] could hardly be considered a money making proposition for an employee" is beside the point. If the sum of an employee's non-deductible personal expenses exceeds his compensation, his entire remuneration could likewise be characterized as not a "money making proposition." But that fact would not exclude his remuneration from "wages" subject to withholding.

pense is fully includable in their tax base and subject to withholding.[14]

3. Finally, petitioner challenges (Br. 11) the court of appeals' conclusion that classification of the meal allowances as "wages" "harmonizes well with the underlying purposes of the withholding tax system to collect income at its source and to prevent unexpected burdensome tax liabilities come April 15" (Pet. App. B 10a). But the exclusion of interest and dividend income from the withholding tax base petitioner cites (Br. 11) does not support its argument that the meal

[14] Nothing in *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1362 (Ct. Cl.), or *Allstate Insurance Co.* v. *United States*, 530 F. 2d 378 (Ct. Cl.), cited by petitioner (Br. 16, 20), casts doubt on the correctness of the decision below. Those cases dealt with the particularized allowance for moving expenses, and held that certain direct and indirect moving expense allowances provided by an employer to its employees were not wages subject to withholding. However, in *Humble Oil*, the court found persuasive the fact that the Internal Revenue Service's published rulings drew a distinction between such allowances to existing and to new employees, and concluded that only the payments to new employees were taxable income (see 442 F.2d at 1369–1370). In *Allstate Insurance Co.*, the court rejected the government's argument that the 1964 enactment of the deduction for direct moving expenses (Section 217) and the concomitant exclusion of direct moving expense reimbursements from the definition of "wages" (Section 3401(a)(15)) rendered indirect moving expense allowances subject to withholding. Thus, both of these cases are far afield from the proper treatment of meal allowances at issue here.

Finally, none of the published rulings petitioner cites (Br. 15) supports its position that the meal allowances are not wages. Each of those rulings involved a situation in which a payment was made before the commencement of an employment relationship or after or in exchange for its termination.

allowances are not "wages." Those items do not arise out of the employment relationship and are therefore not "remuneration * * * for services performed by an employee for his employer."

Indeed, the legislative history confirms the court of appeals' observation that subjection of the meal allowances to withholding tax is consistent with the congressional intention to collect income taxes currently at their source. The Senate Committee report (S. Rep. No. 1631, 77th Cong., 2d Sess. 165 (1942)) cited by petitioner (Br. 11, n. 5) indicates that all remuneration paid by an employer to his employee is subject to withholding taxes if it is includable in the employee's income tax base. As that report noted, the exclusion from wages for wartime military pay (which corresponded to its partial exclusion from gross income (see Revenue Act of 1942, Section 117, 56 Stat. 814)) "[did] not extend to remuneration in the form of pensions and retired pay, if such remuneration [was] includible in gross income under the provisions of section 22 of the Code" (*id.* at 166).[15] Since the meal payments at issue here are fully includable in the employees' gross income and are not deductible or otherwise excludable from their tax base, they likewise fall within the statutory definition of "wages" in Section 3401(a).[16]

[15] See Section 112 of the 1954 Code, which provides an exclusion from gross income for armed forces combat pay. Section 3401(a)(1) likewise excludes such amounts from the definition of "wages." See p. 26, n. 10, *supra*.

[16] As a practical matter, the only reliable means of insuring that the employees will report the meal allowances as income is to subject them to income tax withholding and require their inclusion on the employees' Wage and Tax Statements (Form W-2). For example, in *Commissioner* v. *Kowalski*, No. 76-1095, the taxpayer did not report his meal allowances as income until his employer began to withhold income taxes on them and include them in "wages" on the Form W-2. See Brief for the Petitioner, *Commissioner* v. *Kowalski*, pp. 4–5, nn. 4 and 5.

II.

IF THE MEAL ALLOWANCES ARE WAGES, THE COMMISSIONER'S ASSESSMENT OF UNPAID WITHHOLDING TAXES AGAINST PETITIONER FOR AN OPEN YEAR UNDER THE STATUTE OF LIMITATIONS WAS A PROPER EXERCISE OF HIS AUTHORITY TO ENFORCE THE INTERNAL REVENUE LAWS

Petitionr argues (Br. 25–32) that even if the Court holds, in accordance with our submission, that the meal allowance are "wages" subject to withholding, it is nevertheless entitled to prevail in this refund suit because the Commissioner's assessment for 1963 was a "retroactive imposition" and tantamount to an "abuse of discretion" (Br. 25). In petitioner's view, it should be relieved of the withholding obligation for the year in suit because it was reasonable for it to believe that the meal allowances were not "wages" subject to withholding. Since petitioner would have otherwise collected the taxes at issue from the meal payments, it contends (Br. 25) that it should not be obligated to be a "guarantor" of tax payments later deemed to be subject to withholding.

As a general matter, the only restriction on the Commissioner's authority to assess taxes (Section 6201(a)) in accordance with his obligation to enforce

and administer the internal revenue laws (Sections 7801, 7802) is the three-year statute of limitations (Section 6501(a)). Here, petitioner's "retroactivity" argument does not rest on a claim that the assessment is barred by the applicable period of limitations. Rather, petitioner contends that in 1963 it was reasonably justified in believing that the meal allowances were not wages and that such belief should override what would otherwise be a valid timely assessment.

But the Commissioner's position with respect to the meal allowances is precisely the same as it was in 1963. Then, as now, the Commissioner maintained that the costs of meals consumed in non-overnight travel were non-deductible personal expenses. Indeed, as the Court noted in *United States* v. *Correll, supra,* 389 U.S. at 302 n. 10, the Commissioner first announced his overnight rule in 1940 in I.T. 3395, 1940–2 Cum. Bull. 64, prior to the enactment of the withholding tax provisions. From that time forward, "the Commissioner has consistently construed travel 'away from home' to exclude all trips requiring neither sleep nor rest, regardless of how many cities a given trip may have touched, how many miles it may have covered, or how many hours it may have consumed" *United States* v. *Correll, supra,* 389 U.S. at 302–303 (footnotes omitted).[17]

Thus, petitioner had ample notice since 1940 that the Commissioner viewed the meal allowances as fully

[17] Contrary to petitioner's argument (Br. 26), the situation is therefore distinguishable from *Humble Oil & Refining Co.* v. *United States, supra,* in which the Commissioner's published rulings provided the employer with a reasonable basis for concluding that moving allowances paid to existing employees were not subject to withholding. See p. 29, n. 14, *supra.*

includable in the employees' gross income without any deduction or offset. While petitioner argues (Br. 32) that the Commissioner's overnight rule did not address the question whether such allowances were wages subject to withholding, the promulgation of that rule confirmed that the Service would not accept the claim that such allowances for non-overnight meals were "advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer." Treasury Regulations, Section 31.3401 (a)–1(b)(2) (see p. 3A, *infra*).[18]

Since the meal allowances were an important element of the employees' compensation and did not

[18] Since the Commissioner published the overnight rule in 1940, there is no basis for petitioner's contention (Br. 30) that "[i]n 1963, not one regulation, revenue ruling or judicial decision required withholding on any travel expense reimbursements." Although petitioner now asserts that the Commissioner's overnight rule has no relation to the question whether the meal allowances are wages subject to withholding, it nevertheless claims (Br. 31) that the decision in *Ahrens* v. *United States*, 264 F. Supp. 518 (S.D. Ill.), allowing one of its employees to deduct the meal allowance, provided it with a reasonable basis for believing that the payment was not wages. In its petition for rehearing in the court of appeals (p. 2), petitioner likewise claimed that it was reasonable for it to believe that its "employees would be entitled to income tax deductions for the amounts of the reimbursements." At all events, in deciding in 1963 not to withhold taxes from the meal allowances' petitioner cannot claim to have relied upon the district court's opinion in *Ahrens*, which was not rendered until 1967.

qualify as deductible business expenses, petitioner could not have reasonably believed that the allowances were not wages.[19]

Nor can petitioner draw any support from other pre-*Correll* decisions such as *Hanson* v. *Commissioner,* 298 F.2d 391 (C.A. 8); *Williams* v. *Patterson,* 286 F.2d 333 (C.A. 5); *Chandler* v. *Commissioner,* 226 F.d 467 (C.A. 1); or *Scott* v. *Kelm,* 110 F. Supp. 819 (D. Minn.) (Br. 31). Apart from the fact that it was the posture of the Commissioner, and not the court decisions in other jurisdictions, that petitioner had to consider in determining whether it could safely fail to withhold taxes on the meal allowances, the courts that had rejected the overnight rule proposed other tests for deductibility that petitioner's employees would have failed to meet. See *Hanson* v. *Commissioner, supra,* 298 F.2d at 395–396 n. 3.[20]

[19] Petitioner asserts (Br. 30 n. 29) that "[t]he government is well aware that employers heretofore have not been apprised of the need to withhold." But when read in context, the excerpt from our reply brief in the court of appeals quoted by petitioner does not support its contention that employers were not aware that such meal allowances were subject to withholding. The quoted statement was made as part of a request that if the court of appeals affirmed the district court on the basis of petitioner's "retroactivity" argument, that it also rule on the merits in order to clarify the uncertainty arising from the Fourth Circuit's 1973 *Royster Co.* decision. If the court of appeals had not ruled on the merits, we suggested that petitioner's "alternative [retroactivity claim] would become self-perpetuating" (Reply Br. 15) because employers could claim reliance on *Royster Co.* and avoid a ruling on the merits. For the convenience of the Court, we are lodging with the Clerk copies of the briefs filed in the court of appeals.

[20] For example, in *Williams* v. *Patterson, supra,* upon which petitioner relies (Br. 31), the Fifth Circuit permitted the deduction only if it were reasonable for the employee to need and to obtain sleep or rest during the trip, despite the fact that he might not be away from home for longer than an ordinary work day (see 286 F. 2d at 340). See also *Osteen* v. *Commissioner,* 14 T.C. 1261, 1262, and *Herrin* v. *Commissioner,* 28 T.C. 1303.

In the absence of any factual or legal basis upon which petitioner could have concluded that its meal allowances were not subject to withholding, the Commissioner's assessment of the unpaid taxes does not work any unfairness upon it and is not an impermissible abuse of discretion. Section 3403 of the Code imposes an absolute liability upon the employer "for the payment of the tax required to be deducted and withheld under this chapter." If an employer does not withhold taxes on wages to his employees, he is primarily liable for the payment of such taxes. The fact that petitioner could have collected the taxes from the amounts paid to his employees but failed to do so does not relieve petitioner of its statutory liability for the tax.[21]

Indeed, petitioner easily could have protected itself from the risk of having to pay the tax by seeking a ruling from the Commissioner as to whether the meal allowances were wages subject to withholding. Its failure to seek clarification of the scope of its statu-

[21] The situation is analogous to the various excise taxes imposed upon manufacturers of various items such as automobiles, tires, and firearms. See, *e.g.*, 26 U.S.C. 4061 *et seq.* While the manufacturer may pass on the economic burden of those taxes to the retailers by increasing the wholesale price, his failure to do so does not relieve him of the statutory obligation to pay the tax. Thus, Section 6416(a)(1) of the Code provides that a manufacturer cannot claim a refund for excise taxes unless it has (1) not included the tax in the price of the article; (2) repaid the amount of the tax to the ultimate purchaser; (3) repaid or agreed to repay the tax to the retailer; or (4) filed with the Commissioner the written consent of the retailer to the making of the refund.

tory obligation prior to the payment of the meal allowances should not defeat the collection of a valid and timely assessment.

CONCLUSION

For the reasons stated, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code of 1954 (26 U.S.C. (1958 ed.)):

SEC. 61. GROSS INCOME DEFINED.

(a) *General Definition.*—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, and similar items;
(2) Gross income derived from business;
(3) Gains derived from dealings in property;
(4) Interest;
(5) Rents;
(6) Royalties;
(7) Dividends;
(8) Alimony and separate maintenance payments;
(9) Annuities;
(10) Income from life insurance and endowment contracts;
(11) Pensions;
(12) Income from discharge of indebtedness;
(13) Distributive share of partnership gross income;
(14) Income in respect of a decedent; and
(15) Income from an interest in an estate or trust.

* * * * *

SEC. 3401. DEFINITIONS.

(a) *Wages.*—For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his em-

ployer, including the cash value of all remuneration paid in any medium other than cash; * * *

* * * * *

SEC. 3402. INCOME TAX COLLECTED AT SOURCE.

(a) [as amended by Sec. 2(a), Act of August 9, 1955, c. 666, 69 Stat. 605] *Requirement of Withholding.*—Every employer making payment of wages shall deduct and withhold upon such wages (except as provided in subsection (j)) a tax equal to 18 percent of the amount by which the wages exceed the number of withholding exemptions claimed, multiplied by the amount of one such exemption as shown in subsection (b)(1).

* * * * *

SEC. 3403. LIABILITY FOR TAX.

The employer shall be liable for the payment of the tax required to be deducted and withheld under this chapter, and shall not be liable to any person for the amount of any such payment.

Treasury Regulations on Employment Taxes (1954 Code) (26 C.F.R.):

§ 31.3121(a)–1 *Wages.*

* * * * *

(f) Ordinarily, facilities or privileges (such as entertainment, medical services, or so-called "courtesy" discounts on purchases), furnished or offered by an employer to his employees generally, are not considered as remuneration for employment if such facilities or privileges are of relatively small value and are offered or furnished by the employer merely as a means of promoting the health, good will, contentment, or efficiency of his employees. The term "facilities or privileges", however, does not ordinarily include the value of meals or lodging furnished, for example, to restaurant or hotel employees, or to seamen or other employees aboard vessels, since generally these items constitute an appreciable part of the total remuneration of such employees.

* * * * *

§ 31.3401(a)–1 *Wages.*

(a) *In general.* * * *

(2) The name by which the remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, pensions, and retired pay are wages within the meaning of the statute if paid as compensation for services performed by the employee for his employer.

(3) The basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profits; and may be paid hourly, daily, weekly, monthly, or annually.

* * * * *

(b) *Certain specific items*—* * *

(2) *Traveling and other expenses.* Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding. * * *

* * * * *

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In the

Supreme Court of the United States

OCTOBER TERM, 1976

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

vs.

UNITED STATES OF AMERICA

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

REPLY BRIEF FOR THE PETITIONER

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REPLY BRIEF FOR THE PETITIONER

ARGUMENT

I.

THE GOVERNMENT'S ARGUMENT THAT ANY BENEFIT ARISING FROM THE EMPLOYMENT RELATIONSHIP CONSTITUTES A "WAGE" IS PREMISED ON BASIC FALLACIES

The Internal Revenue Code ("the Code") limits the term "wages" for withholding tax purposes to "remuneration . . . for services performed." Section 3401(a). The intent of Congress to confine the scope of employers' with-

holding obligations long has been reflected in administrative practice and the established principle that reimbursements made to employees for legitimate expenses incurred in travel for the employer's business are not "wages" subject to withholding.

The government now urges upon this Court a sweeping definition:

> The statutory concept of "wages" is not tied to the performance of any particular service, but includes any personal economic benefit given by an employer to his employee as a result of the employment relationship.

Gov't. Br. 20.[1] Acceptance of the government's view, however, requires a departure not only from the definition codified by Congress but from administrative practice and judicial precedent as well. The government's proposed definition is premised upon two erroneous assumptions: (1) that every economic benefit to an employee represents "income" and (2) that every item of income represents a "wage" for withholding purposes.

A. Reimbursements For Travel Expenses Long Have Been Excluded From "Wages" Because Not "For Services Performed"

Both courts below specifically acknowledged that the reimbursements involved here were legitimate expenses incurred by employees for travel on behalf of the Petitioner ("the Company") (App. 16, 22). Treasury Regulations §31.3401(a)-1(b)(2)—which traces back to 1943 and

[1] References herein to "Gov't. Br." are to the Brief for the United States. "Br." refers to the Brief for the Petitioner.

the inception of the present withholding system—provides in pertinent part:

> Amounts paid specifically—either as advances or reimbursements—for traveling or other bona fide ordinary and necessary expenses incurred or reasonably expected to be incurred in the business of the employer are not wages and are not subject to withholding.

The government attempts to discredit this regulation through a strained construction of its terms and through complete disregard of the underlying rationale for the regulation—*i.e.*, that noncompensatory payments primarily for the business of the employer are not, and never have been, wages.

The government maintains that the regulation excludes from "wages" only payments with respect to which the recipient is entitled to an offsetting business expense deduction. Gov't. Br. 26. In support of this contention, the government argues that the phrase "ordinary and necessary" is a statutory term of art that refers to the deductible expenses under Section 162 (a) of the Code. It then concludes that the deduction which the regulation contemplates is that of the employee and not that of the employer.[2]

The government's strained interpretation is repudiated by the express language of the regulation. The emphasis is upon "amounts *paid*," not amounts received, and upon "ordinary and necessary expenses incurred . . . in the business of *the employer*," rather than deductibility to the employee (emphasis supplied). Indeed, the ability of an em-

[2] Here, the government has not challenged, nor could it challenge, the right of the Company to deduct as "ordinary and necessary" business expenses what both courts below recognized to be legitimate travel expenses.

ployee to obtain an offsetting business deduction is wholly irrelevant to the application of the regulation, which determines only the *employer's* obligation.

Moreover, the government's interpretation of the regulation is inconsistent with its own rulings holding that various payments representing nondeductible income to an employee do not constitute "wages." *See* Rev. Rul. 55-520, 1955-2 Cum. Bull. 393; Rev. Rul. 56-249, 1956-1 Cum. Bull. 488; Rev. Rul, 58-301, 1958-1 Cum. Bull. 23; Rev. Rul. 58-145, 1958-1 Cum. Bull. 360; Rev. Rul. 59-227, 1959-2 Cum. Bull. 13.[3]

Any reasonable reading of this regulation would reveal that withholding is not required with respect to any reimbursements for legitimate travel expenses. The regulation obviously makes no attempt to distinguish between overnight and nonovernight trips. The government nevertheless contends that its "overnight rule," denying *employees* an *income* tax deduction for travel reimbursements, should now control the withholding tax obligations of employers. Gov't Br. 25-26. But the "overnight rule," which the government says has been outstanding since 1940, was not incorporated—or even reflected in any way—in the withholding regulations adopted only three years later.

[3] The government attempts to distinguish these rulings by claiming that each involved a payment which somehow was made outside of the employment relationship—such as before it began, after it terminated or in exchange for its termination. The government does not explain how this argument coincides with its earlier argument that "a continuing employment relationship is not a prerequisite" for treating a payment as a "wage." *Compare* Gov't. Br. 29 n.14 *with* Gov't. Br. 19. In any event, the government's position is clear: it is asking this Court to overlook the government's long-established rulings.

The government, in its efforts to bootstrap a rule addressed to employees' income tax treatment into a withholding requirement for employers, fails to answer the ultimate question of how an item which is a non-wage item when a trip is for overnight is somehow converted into a "wage" when a legitimate business trip is for a lesser period. Certainly expenses incurred on nonovernight trips are no less legitimate travel expenses to the Company than those incurred on overnight trips and have no different effect to the employees.[4] In this case, the exact same amount of meal reimbursement was paid to employees whether traveling on overnight or nonovernight trips for the employer (App. 16, 22; Tr. 24-29, 37). As the Fifth Circuit observed in *Stubbs, Overbeck & Associates, Inc.* v. *United States*, 445 F.2d

[4] It is questionable whether employees of the Company received any economic benefit due to the meal reimbursement policy. When not traveling on behalf of the Company, most employees ate lunch at home at a cost likely to be less than the difference, for example, between $1.40 and the actual cost of purchasing a meal when traveling. *See also* the opinion of the district court below, wherein it is remarked:

> The evidence disclosed that depending on the individual and the circumstances the $1.40 rate was sometimes in excess of the actual lunch cost, but very often it was insufficient to cover the cost. . . . Even in 1963 the $1.40 rate was modest considering that many of these employees were men engaged in open air labor. As a practical matter, it could hardly be considered a money making proposition for an employee.

App. 16-17. Further, a benefit is not always conferred upon a traveling employee through reimbursement of meal expenses when it is noted that the meal often is consumed under varying circumstances at unfamiliar facilities of questionable quality.

1142, 1147 (5th Cir. 1971): "The payments are either wages or not from beginning to end, assuming there is no change in the factual situation other than the passage of time."[5]

B. Not Every Economic Benefit Represents A "Wage"

The expansive definition of "wages" advanced by the government would tie the term to any economic benefit

[5] Apparently recognizing this weakness in its argument, the government also has attempted to summarize the facts in this case so that the reimbursements appear more like "remuneration" than merely travel expense payments. Thus, the government states or suggests that the amount of the reimbursements: (i) varied according to an employee's seniority status (Gov't. Br. 3, 21-22 n.9); (ii) were not distinguished on an employee's paycheck from salary (Gov't. Br. 4); (iii) comprised an appreciable part of an employee's total remuneration (Gov't. Br. 19 n.7, 33); (iv) were not audited with respect to non-union employees (Gov't. Br. 3); and (v) were received in "many" cases when employees carried their lunch (Gov't. Br. 4). These simply are not the facts, as the government well knows or should know from the record. As the record shows, there was no correlation between seniority or rate of pay and amount of reimbursement (App. 17; Tr. 29-30; 44-45); the reimbursements were not, and could not have been, an appreciable part of an employee's remuneration because they were so small (App. 16-17); all employees were required to comply with accounting procedures of the Company, which were carefully supervised, in order to obtain meal reimbursements (App. 16; Tr. 32-38, 64-66); the reimbursement amount was specifically identified as travel expense upon payment to the employee (Tr. 39-40; Plaintiff's Ex. 11); employees rarely carried their lunch and then only for the convenience of the Company (Tr. 94, 113, 117, 124, 128, 135, 140-41).

somehow attributable to the employment relationship. However, the notion of "economic benefit" has never served as a suitable explanation of "income," much less "wages." The Department of the Treasury has remarked:

> It is sometimes asserted simply that income includes any "economic benefit" received. . . . But the concept of "economic benefit" does not explain 60 years of actual experience.

Office of the Ass't Sec'y for Tax Policy, Summary and Discussion Draft of Proposed IRS Regulations on Employee Fringe Benefits, Daily Tax Report (BNA), No. 172 at J-7 (September 4, 1975).[6]

Indeed, "actual experience" demonstrates that economic benefit is not the determinative feature of income. As early as 1920, in an unrevoked Official Decision of the Internal Revenue Service, it was recognized that "supper money" provided to employees by their employers did not represent taxable income to the employees, as long as it was provided "for the convenience of the employer." O.D. 514, 2 Cum. Bull. 90 (1920). *See also* Treasury Regulations §1.119-1(a)(2)(i). In like manner, facilities and privileges, either to accommodate business requirements or to pro-

[6] The Department of the Treasury also noted:

> The Internal Revenue Code states simply that gross income means all income from whatever source derived. . . . [Section 61] As a definition, that language has an obvious defect, for to say that gross income includes income still fails to tell us what income is. The statutory language should be viewed rather as broad authorization to reach such items as may be appropriate, in the context of our overall system. It is clearly broad enough to encompass almost any economic benefit, but it is equally clear that it has not been construed to do so. . . . [M]ost of the hundreds of pages of the Internal Revenue Code were written to help draw the lines between what will and what will not be treated as income.

mote good will (*e.g.*, courtesy discounts) do not result in gross income to employees.[7]

Proceeding from the erroneous assumption that economic benefit is the hallmark of income, the government maintains that there is a general "equivalence" between income and wages in the employment context. *See, e.g.*, Gov't. Br. 15, 21 n.8. This over-simplified equation may appear seductive but it represents a marked departure from settled practice and is without logical basis. Neither administrative practice of the Internal Revenue Service nor judicial determination support the government's contention. Further, even the government retreats from a pure equivalence theory and suggests that an item of travel reimbursement to an employee becomes a "wage" only in the absence of an offsetting deduction to the employee. Gov't. Br. 25 *et seq.*

The government's rulings long have recognized the fundamental distinction between an employee's income and an

[7] Any relationship between economic benefit and income is exceedingly difficult to define. The government itself has been unable to articulate tax standards with respect to employee fringe benefits. *See* Br. 23 n.17. As recently as August 30, 1977, the Internal Revenue Service indicated that no decision had been made on which fringe benefits, not currently taxed, should be treated as income to employees. *See* Daily Tax Rep. (BNA), No. 169 at G-6. This Court has on occasion considered the meaning of "gross income" in specific contexts. *See, e.g., Commissioner* v. *Lobue*, 351, 243 (1956); *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716 (1929). However, it has never been considered, contrary to the government's apparent suggestion (Gov't. Br. 17-18, 21 n.8), that this Court was undertaking the impossible task of defining the concept for all circumstances. Further, in such "income" cases this Court was never asked to focus on the issue of whether *all* gross income received in the employment context constituted "remuneration . . . for services performed" and thus "wages" for withholding purposes.

employer's withholding obligation. *See generally* discussion in Br. 14-15. In its rulings, the government specifically holds that not every payment by an employer which is nondeductible income to an employee is a "wage" subject to withholding. *See, supra*, note 3 and accompanying text.

A settled line of judicial precedent also has recognized the distinction. The government attempts to dismiss the cases, stating:

> Once it is recognized that the meal allowances are includable in the employees' gross income and not deductible by them as business expenses, the lower court opinions upon which petitioner relies (Br. 15-16) are distinguishable.

Gov't. Br. 27. But each case expressly states that the income tax consequence to an employee is irrelevant to the issue of whether the employer must treat the reimbursements as "wages" for withholding purposes.[8]

In the *Humble* cases and *Allstate*, the Court of Claims held that payments or reimbursements by an employer of its existing employees' "indirect" moving expenses were not "wages," notwithstanding its prior ruling in *Ritter* v. *United States*, 393 F.2d 823 (1968), that such payments were nondeductible income to the employees.[9]

[8] *See, e.g., Peoples Life Insurance Co.* v. *United States*, 373 F.2d 924, 932-33 (Ct. Cl. 1967); *Acacia Mutual Life Insurance Co.* v. *United States*, 272 F.Supp. 188, 194-95 (D. Md. 1967); *Humble Pipe Line Co.* v. *United States*, 442 F.2d 1353, 1356 (Ct. Cl. 1971); *Humble Oil & Refining Co.* v. *United States*, 442 F.2d 1363, 1365-67 (Ct. Cl. 1971). *See also Allstate Insurance Co.* v. *United States*, 530 F.2d 378, 383 Ct. Cl. 1976).

[9] The government mistakenly asserts that the Court of Claims held in *Humble Oil* that such payments were not taxable income to existing employees. Gov't. Br. 29 n.14. The passage in *Humble Oil* which the government has mis-

The issues in the *Humble* cases and *Allstate* are precisely the same as in this case, *i.e.*, whether payments made by employers to employees for bona fide business reasons unrelated to their compensation are "wages," even if such payments are taxable income to employees.[10]

The government is also mistaken in its treatment of *Stubbs, Overbeck & Associates, Inc.* v. *United States,* 445 F.2d 1142 (5th Cir. 1971), in which the court held that per diem payments made by an employer as a personal living allowance to employees located at a remote job site did not constitute "wages." The government attempts to characterize the *Stubbs* decision as "turn[ing] upon the fact that the employee's assignment was away from home overnight, so that his expenses were deductible." Gov't. Br. 28 n.12. But the Fifth

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[9] (Continued)
read points out that, while revenue rulings existing at the time for withholding would have informed the employer that reimbursements of "indirect" moving expenses constituted nondeductible income to both new and existing employees, such rulings required *withholding* only with respect to *new* employees. *See* 442 F.2d at 1369-70. Thus, *Humble Oil* also confirms that the government has an obligation to give employers reasonable advance notice of withholding requirements. *See, infra,* pp. 14-15.

[10] Congress eventually dealt with moving expense reimbursements through precise and specific legislation, rather than by engaging in drastic overhaul of the entire withholding system as the government urged upon the Court of Claims then and urges upon this Court today. Congress specified in Section 82 of the Code that employer reimbursements for moving expenses should be treated not only as gross income but specifically as "compensation for services." This provision would be unnecessary if, as the government suggests, all items of gross income are "wages."

Circuit did not mention or allude to the overnight rule, a concept having application to employees, in its determination of an employer's withholding responsibility. There is no reason to suppose that the *Stubbs* court did not mean what it said in concluding that the deductibility of such allowances by employees was "immaterial" to its decision because "we are not concerned with what constitutes taxable income to the employee."[11] 445 F.2d at 1149.

The government's departure from established practice would not only tie the term "wages" to a protean concept capable of embracing whatever the government sees fit but could lead to the further absurdity of requiring employers to look to the deductions of individual employees in determining withholding obligations. *See* Gov't. Br. 13-14, 26. The government opines that "an employer surely can estimate whether the reimbursements provided to his employees can reasonably be expected to exceed his actual expenses." Gov't. Br. 26 n.10. But forcing an employer, such as the Company, with thousands of employees to make such estimates with respect to *each* employee and *each* kind of expense allowance for *each* payment period before any reimbursements are issued would be an administrative nightmare.

Acceptance of the government's view of "wages" would work a fundamental revision of employers' withholding obligations and would effect a radical overhaul of the withholding system. The government is in effect seeking judicial legislation from this Court.

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[11] A significant point made by the *Stubbs* court, and ignored by the government, is that "[a]n employee may receive *economic benefits* from his employer that are not subject to the withholding provisions of the Code" (emphasis supplied). 445 F.2d at 1149.

II.

THE GOVERNMENT'S CONCESSION THAT WITHHOLDING SHOULD NOT BE REQUIRED RETROACTIVELY IF A FACTUAL OR LEGAL BASIS JUSTIFIES NOT WITHHOLDING REQUIRES A DECISION FOR PETITIONER

In the Company's opening brief, it is argued that the government's attempt in this case to apply withholding requirements retroactively is an abuse of discretion. It was noted that Congress condemns such retroactive enforcement because it "creates havoc" in the withholding system. Br. 25-32. Moreover, it is fundamentally unfair to require employers to pay their employees' taxes merely because, at the time for withholding, they failed to predict future changes in the tax laws.

The government's response is a conclusory assertion:

> In the absence of any factual or legal basis upon which petitioner could have concluded that its meal allowances were not subject to withholding, the Commission's assessment of unpaid taxes does not work any unfairness upon it and is not an impermissible abuse of discretion.

Gov't. Br. 35. Thus, the government concedes, as it must, that if, in 1963, the Company did not withhold on travel expense reimbursements because there was a factual or legal basis for not withholding, retroactive enforcement of withholding rules would be an abuse of discretion. *See* Rev. Rul. 69-592, 1969-2 Cum. Bull. 193. The government's contention that the Company could not have concluded in 1963 that any such factual or legal basis existed is without support.

A. In 1963, Long-Standing Treasury Regulations Explicitly Stated That Reimbursements For Travel Expenses Were Not "Wages"

In 1963, Treasury Regulations § 31.3401(a)-1(b)(2) provided, as it does today, that amounts paid for traveling or other bona fide ordinary and necessary expenses incurred in the business of the employer are not wages and are not subject to withholding. Both courts below found that the noon meal reimbursements in this case were for legitimate travel expenses (App. 16, 22). Under the circumstances, no employer could reasonably have suspected that any withholding requirement existed.

The government contends that the Company should have known that this regulation was not applicable because its "overnight rule," which denies *income* tax deductions to employees, had been announced in 1940. Gov't. Br. 32-33. However, the government does not explain how the "overnight rule" could have application to an employer's withholding obligation. Neither does it explain why, if the "overnight rule" was relevant to withholding, the government did not notify employers of this fact by incorporating the overnight rule into the withholding regulations which it drafted only a few years later in 1943.[12] *See*, *supra*, pp. 4-5.

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[12] In the Company's opening brief, it is observed that "[i]n 1963, not one regulation, revenue ruling, or judicial decision required withholding on any travel expense reimbursements." Br. 30. The government disputes this statement solely on the basis that its overnight rule was outstanding in 1963. Gov't. Br. 33. But the government utterly fails to show any official announcement by it which would have informed employers that the overnight rule had any relevance to withholding.

B. Judicial Authority In 1963 Held That Employees Were Entitled To An Offsetting Income Tax Deduction

In fact, in 1963 it was not even clear that meal reimbursements were taxable income to employees (because of offsetting deductions), much less "wages." *See* Br. 31-32 and cases cited therein. This question was not answered until four years later, in this Court's decision in *United States* v. *Correll*, 389 U.S. 299 (1967), which turned on administrative convenience rather than a literal interpretation of the statutory language. The result in *Correll* was not clearly foreshadowed; indeed, it overruled decisions in *Hanson* v. *Commissioner*, 298 F.2d 391 (8th Cir. 1962), *Chandler* v. *Commissioner*, 226 F.2d 467 (1st Cir. 1955), and *Scott* v. *Kelm*, 110 F.Supp. 819 (D. Minn. 1953), all of which were outstanding in 1963.[13] Courts continued to reject the "overnight rule" after 1963. *See Correll* v. *United States*, 369 F.2d 86 (6th Cir. 1966), *rev'd*, 389 U.S. 299 (1967); *William A. Bagley*, 46 T.C. 176 (1966); *Ahrens* v. *United States*, 264 F.Supp. 518 (S.D. Ill. 1967).

C. Employers Have A Right To Be Told In Advance Of Any Changes In Long-Standing Withholding Policy

The government suggests that:

> [P]etitioner easily could have protected itself from the risk of having to pay the tax by seeking a ruling from the Commissioner as to whether the meal allowances were wages subject to withholding.

Gov't. Br. 35.

But it is absurd to place the burden on employers to protect themselves from unannounced changes in government withholding policy. Under the withholding system employers are agents of the government for the collection of the revenue. As such, the government owes them the duty to inform them *in advance* of fundamental changes in their withholding obligations. Moreover, as Congress has recognized, the exigencies of time and the momentum of the payroll collection process demand that employers be able to rely on administrative practice.[14] Employers cannot postpone weekly or monthly withholding decisions while they wait for a ruling from Washington, which may or may not be forthcoming.

The crowning irony of the government's suggestion that the Company should have foreseen a withholding requirement in 1963 is that, fourteen years later, the government itself apparently does not withhold on similar reimbursements. Br. 23-24, n.18.

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[13] The government suggests that "the courts that had rejected the overnight rule proposed other tests for deductibility that petitioner's employees would have failed to meet." Gov't. Br. 23. There is no basis for this assertion. In fact, based on these cases, one of the Company's employees was allowed a deduction for noon meal reimbursements of the exact type here in issue. *See Ahrens, infra.*

[14] *See* Statements of the Chairman and ranking member of the Senate Finance Committee, 122 Cong. Rec. S12,496 (Daily ed. July 26, 1976), adopted by reference by the Conference Committee for the Tax Reform Act of 1976, S.Rep. No. 1236, 94th Cong., 2d Sess. 489, *reprinted* in 1976-3 Cum. Bull. 807, 893. The senators emphasize that Congress deplores retroactive enforcement by the Internal Revenue Service of changed rules in the withholding tax area. *See also* Br. 27.

CONCLUSION

For the reasons stated in Petitioner's Briefs the judgment of the Court of Appeals should be reversed. Petitioner also requests a remand to the district court for the award of attorneys' fees pursuant to 42 U.S.C. §1988 (1976).

Respectfully submitted,

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Respondent.

On Writ of Certiorari to the United States
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BRIEF OF AMERICAN GAS ASSOCIATION, AS AMICUS CURIAE, IN SUPPORT OF PETITIONER

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1058

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

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BRIEF OF AMERICAN GAS ASSOCIATION, AS AMICUS CURIAE, IN SUPPORT OF PETITIONER

The American Gas Association files this brief in support of the petitioner, pursuant to Rule 42. Counsel for all parties have consented to the filing of this brief and have been properly served.

INTEREST OF AMICUS CURIAE

The American Gas Association is the national trade association for approximately 300 member companies providing natural gas distribution and transmission services to 160 million consumers in all 50 states. These member companies serve approximately 93 percent of the 43 million homes, businesses and industrial facilities which use natural gas. The purpose of the Association is to further the development of the gas industry and its service of the public interest.

Like the petitioner, members of the Association have service responsibilities over transmission and distribution networks covering extensive geographical areas. In order to fulfill these responsibilities, their employees must be temporarily assigned to the field, away from normal work stations. In the instant case, the petitioner made meal reimbursements to employees so assigned, without regard to their level of compensation. Many members of the Association also have reimbursement programs because they have found that employees on travel status encounter conditions which contribute to greater fatigue and enhanced appetite, stimulating increased nutritional requirements which must be accommodated at unfamiliar facilities. Like the present case, these reimbursements do not represent payments for services performed by the employees; there is no correlation between the amount of the reimbursement and the compensation level of the recipient.

These reimbursements have traditionally been viewed as non-remunerative business disbursements. Member companies have relied upon the uniform approach of case law, together with rulings of the Internal Revenue Service, which have all recognized that reimbursements made for non-remunerative business purposes of the employer do not constitute wages subject to withholding. However, recent rulings by the Service, and the Seventh Circuit's decision in this case, set forth a new approach which, if affirmed by this Court, would reclassify a significant portion of these reimbursement payments as wages, without regard to their non-remunerative nature. This approach is not only contrary to the language of the withholding statutes and existing case law, but it also poses a significant threat to the administrative viability of member programs. In addition, the new standard is being asserted retroactively, thereby threatening the imposition of unwarranted, retroactive economic penalties upon many member companies, whenever the Service decides to reject judicial interpretations of the statutory definition of wages.

ARGUMENT

I. The Employer's Business Purpose for Employee Reimbursements Should Determine Their Non-Remunerative Nature.

Section 3402 of the Internal Revenue Code of 1954 imposes a duty upon an employer to withhold income taxes from "wages", a term defined in § 3401(a) as "* * * all remuneration * * * for services performed by an employee for his employer * * * *". Accordingly, the withholding issue turns upon whether an employer's reimbursements constitute additional remuneration for services, or are paid for a business purpose which is unrelated to compensating employees for their services. The issue arises in this case because the reimbursed expenses were incurred for meals, which are items of personal consumption. However, when meals are consumed in business circumstances dictated by the requirements of the employer (as in this case), reim-

bursement of their cost is obviously a business charge which does not represent remuneration for services.

Contrary to the government's position, this business character is not changed merely because, in computing taxable income of employees, a distinction is made between overnight and non-overnight business travel. All of the decided cases, except the holding below, have treated the employee's tax situation as irrelevant. The outcome of these cases has uniformly turned upon the employer's business purpose for making the reimbursement.

The Service's earliest recognition of this standard came in O.D. 514, 1920-2 C.B. 90. It held that supper money disbursements to employees performing voluntary overtime work did not constitute taxable income, or wages, because the payments were made for the convenience of the employer. The business purpose of the employer was again considered determinative in Rev. Rul. 190, 1953-2 C.B. 303, and Rev. Rul. 54-429, 1954-2 C.B. 53. Moreover, as recently as 1959, the Service, relying upon the employer's non-remunerative business purpose, ruled that per diem allowances for employees on temporary assignment to remote job sites were not wages during the first year of the assignment. Rev. Rul. 59-371, 1959-2 C.B. 236.

Judicial analysis of employer reimbursement programs has followed the same standard. In *Stubbs, Overbeck & Assoc.* v. *United States,* 445 F.2d 1442 (5th Cir. 1971), the sole issue was the validity of the one-year limitation contained in Rev. Rul. 59-371 on the non-remunerative nature of per diem payments. The court invalidated the one-year rule and held that per diem allowances continuing beyond one year were not wages where the employer still considered them to be

reimbursements for temporary expenses incurred in its business. The courts have consistently applied this business purpose standard in other circumstances, and found that disbursements for various employee expenses did not constitute remuneration for services. *Humble Oil & Refining Co.* v. *United States,* 442 F.2d 1362 (Ct. Cl. 1971), *Humble Pipe Line Co.* v. *United States,* 442 F.2d 1353 (Ct. Cl. 1971), *Allstate Insurance Co.* v. *United States,* 530 F.2d 378 (Ct. Cl. 1976), (reimbursements for indirect moving expenses); *Peoples Life Insurance Co.* v. *United States,* 373 F.2d 924 (Ct. Cl. 1967), *Acacia Mutual Life Insurance Co.* v. *United States,* 272 F. Supp. 188 (Ct. Cl. 1967), (payment of company convention expenses).

Most recently, in *Royster Co.* v. *United States,* 479 F.2d 387 (4th Cir. 1973), the Fourth Circuit held that noon meal reimbursements to traveling salesmen did not constitute wages. The court noted expressly that the reimbursements were made without regard to the compensation levels of the various employees. It also found that the program was motivated by the employer's business purpose of keeping its salesmen in the field, thereby reducing transportation costs.

The first departure from the business purpose standard occurred in Rev. Rul. 69-592, 1969-2 C.B. 193. In that ruling, the Service relied upon this Court's decision in *United States* v. *Correll,* 389 U.S. 299 (1967), which held that day travel meal expenses were not deductible by the employee under § 162(a)(2); the Service ruled that the payments for those expenses were wages unless it was reasonable to believe the employee's deductible expenses for the year would, in the aggregate, exceed total meal allowances and per diem payments. The Service recently applied the same standard in Rev. Rul. 76-453, 1976-47 I.R.B. 6, revoking Rev. Rul. 190

and Rev. Rul. 59-371. In that ruling the Service held that certain employee transportation expenses were not deductible by the employee and, accordingly, were wages when reimbursed by the employer.

The essence of these recent rulings, and the government's position here, is that (1) reimbursements create § 61 gross income, (2) taxable income is created if the employee is unable to deduct the expenditure, due to the rules of § 62 (adjusted gross income) and § 162 (business expenses), and (3) the existence of taxable income requires withholding. This approach has nothing to do with distinguishing between remunerative and non-remunerative reimbursements. Moreover, it has been explicitly rejected as a distortion of the requirement of § 3401(a) that the employer withhold taxes from "wages", defined as "remuneration for services performed by an employee for his employer". In *Stubbs, Overbeck & Assoc.* v. *United States,* 445 F.2d 1142, 1149 (5th Cir. 1971), involving the wage status of per diem payments, the court stated:

> * * * Whether or not payments were taxable to, or deductible by, the employee is immaterial with regard to whether they are subject to withholding by the employer * * * *

The Court went on to state that an employee may receive payments which are includable in his taxable income, because they constitute an economic gain, but are not "wages" as defined in § 3401(a). Likewise, the Court of Claims noted in *Humble Pipe Line Co.* v. *United States,* 442 F.2d 1353, 1356 (Ct. Cl. 1971), that "* * * the term 'wages' has a much narrower meaning than the term 'income' because wages are merely one form of income". This same principle has also been recognized in *Peoples Life Insurance Co.* v. *United States,* 373 F.2d 924, 932; *Allstate Insurance Co.* v.

United States, 530 F.2d 378, 383; *Humble Oil & Refining Co.* v. *United States,* 442 F.2d 1362, 1368; *Acacia Mutual Life Insurance Co.* v. *United States,* 272 F. Supp. 188, 195.

In this case, the government is attempting to make the concept of remuneration for services under § 3401(a) subordinate to the development of deduction rules under § 62 (adjusted gross income) and § 162 (business expenses). This approach has been rejected by the case authorities discussed above. In addition, such a result could hardly have been within the contemplation of Congress. Where deductibility has been considered material in withholding determinations, Congress has expressed itself clearly. *See* § 82, § 217, §3401(a)(15).

Moreover, the rule urged by the government would greatly disrupt the administration of per diem and flat-rate reimbursement programs. The business purpose of the reimbursement and the business reasons for the expense would be ignored. Instead, in determining their withholding obligations, employers would be required to treat each type of reimbursed expenditure separately and then analyze its deductibility to each individual employee. For example, with respect to per diem programs, an employer would have to extract and separately test each element of cost, thereby placing its withholding obligations in a state of confusion.

Only by viewing reimbursement programs from the standpoint of the business purpose of the employer can non-remunerative reimbursements be distinguished from wage compensation. Only this standard discloses the existence of a business purpose unrelated to remuneration for services, which is the essence of the definition of wages under § 3401(a).

II. Retroactive Imposition of a Withholding Tax Constitutes an Unjust Penalty When Failure to Withhold Was Consistent with Then Current Authority.

Since an employer is a mere collection agent for the government, it should not be subject to taxation under § 3403 until it has been clearly advised of its withholding obligations on the payments in question. For the tax year in issue (1963), the petitioner had no notice that meal money reimbursements might constitute wages. On the contrary, the petitioner, in reliance upon the business purpose standard, had reason to believe that its reimbursements were not wages. It was not until 1969 that the Service, in Rev. Rul. 69-592, departed from the business purpose standard for determining whether reimbursements are wages and first notified employers that meal money reimbursements might be subject to withholding. The petitioner, as well as other similarly situated taxpayers, should not be penalized for relying in good faith upon an established approach to the definition of wages, particularly when they had no notice in 1963 of a contrary government position.

The real issue in this case is not the liability of the petitioner under § 3403. The real issue in this case is the income tax liability of individual employees who received meal payments. However, no such liability has been asserted against these employees. Purely for administrative convenience, the government is attempting to collect these individual liabilities from a single source by retroactively redefining the term "wages". Unfortunately, the withholding structure creates a convenient vehicle for this type of abuse.

The government has attempted, without success, to accomplish similar results in earlier cases. In *Peoples*

Life Insurance Co. v. *United States,* 373 F.2d 924, 933 (Ct. Cl. 1967), the Court of Claims rejected the government's attempt to impose a withholding tax liability upon company convention expenses and observed that the withholding statute had not been intended "* * * as a device * * * to determine the basic tax liability of the employee, who (was) not even a party to the case". This theme was reiterated in *Humble Oil & Refining Co.* v. *United States,* 442 F.2d 1362, 1369 (Ct. Cl. 1971), where the court expressed concern that the Service had not given employers notice that reimbursements for indirect moving expenses would be considered wages.

With respect to moving expense reimbursements, Congress changed the law in order that reimbursed indirect moving expenses would come within the statutory definition of wages. *See* § 82, § 217 and § 3401(a)(15). Rather than seeking similar Congressional assistance in this situation, the government is now asking this Court to distort the statutory definition of wages —remuneration for services—to include the meal payments in issue.

CONCLUSION

The payments in issue should be governed by the statutory definition of wages interpreted in the context of the employer's business purpose. In that context, these payments do not fall within the statutory definition of wages, since they are not remuneration for services. In any event, the government should not be allowed to impose a withholding liability, on a retroactive basis, by asking this Court to adopt a new and

expanded interpretation of a clearly-stated statutory definition.

Respectfully submitted,

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